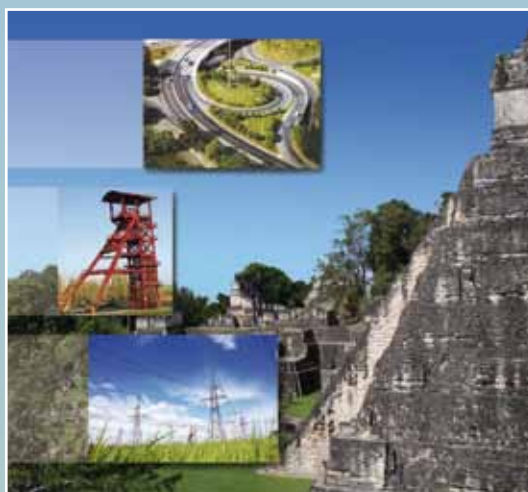


UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

# INVESTMENT POLICY REVIEW

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# GUATEMALA



UNITED NATIONS



**United Nations Conference on Trade and Development**

**Investment Policy Review**  
**Guatemala**



**UNITED NATIONS**  
**New York and Geneva 2011**

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## PREFACE

The UNCTAD *Investment Policy Reviews* (IPRs) are intended to help countries improve their investment policies and to familiarize governments and the international private sector with an individual country's investment environment. The reviews are considered by the UNCTAD Commission on Investment, Enterprise and Development. The recommendations of the IPR are then implemented with the technical assistance of UNCTAD. The support to beneficiary countries is delivered through a series of activities which can span over several years.

The *Investment Policy Review of Guatemala*, initiated at the request of the Government of Guatemala, was carried out through a fact-finding mission in November 2009, and is based on information made available to UNCTAD until October 2010. The mission received the full cooperation of the relevant ministries and agencies, in particular the Ministry of Economy and Invest in Guatemala, the national investment promotion agency. The mission also benefited from the views of the private sector, foreign and domestic, bilateral donors and development agencies. A preliminary version of this report was discussed with stakeholders at a national workshop in Guatemala City on 27 September 2010. The final report reflects written comments from various ministries and agencies of the Government of Guatemala.

The relevance and effectiveness of the regulatory regime is assessed against several related criteria: (a) whether the regulation adequately promotes and protects the public interest; (b) whether the regulation adequately promotes investment and sustainable socio-economic development; and (c) whether the policies employed are effective and well administered, given their public interest and development objectives and the legitimate concerns of investors that rules and procedures do not unduly burden their competitiveness. International benchmarks and best policy practices are taken into account in making the assessment and recommendations in this report.

In addition to reviewing the investment framework, the report, following a specific request from the Government of Guatemala, elaborates on attracting FDI in electricity, road infrastructure and mining.

The report was prepared by the Investment Policy Reviews Section under the supervision of Chantal Dumasquier. James Zhan, Director of the Investment and Enterprise Division provided overall guidance. The report was written by Rory Allan, Hans Baumgarten, Lizzie Medrano de Gamberale, Massimo Meloni and Antonio Moretti. Substantive contributions from Stephen Darrow, Quentin Dupriez and Anna Joubin-Bret are also acknowledged. The report benefited from comments and suggestions from UNCTAD colleagues under a peer review process. Irina Stanyukova provided research assistance and Jovan Licina provided production support. This report was co-funded by the Government of Guatemala and the Government of Sweden.

It is hoped that the analysis and recommendations will contribute to improved policies, promote dialogue among stakeholders, catalyse investment and the beneficial impact of FDI and ultimately help Guatemala achieve its development objectives.

Geneva, December 2010



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## ACRONYMS

ADR	alternative dispute resolution
AMCHAM	American – Guatemalan Chamber of Commerce
AMM	Administrador del Mercado Mayorista
ANADIE	Agencia Nacional para el Desarrollo de la Infraestructura Económica
BAT	best available technology
BIT	bilateral investment treaty
BPO	business processing outsourcing
BVNSA	Bolsa Nacional de Valores S.A.
CACM	Central American Common Market
DR-CAFTA	Central America–Dominican Republic–United States Free Trade Agreement
CBI	Caribbean Basin Initiative
CICIG	Comisión Internacional contra la Impunidad en Guatemala
CONADIE	Consejo Nacional para el Desarrollo de la Infraestructura Económica
CORFINA	Corporación Financiera Nacional
CNEE	Comisión Nacional de Energía Eléctrica
CSR	corporate social responsibility
DTT	double taxation treaty
ECLAC	United Nations Economic Commission for Latin America and the Caribbean
EPZ	export processing zone
FDI	foreign direct investment
FTA	free trade agreement
FVG	Ferrovías de Guatemala
GDP	gross domestic product
GFCF	gross fixed capital formation
GNI	gross national income
GWh	gigawatt
HCCH	The Hague Conference on Private International Law
IADB	Inter-American Development Bank
ICSID	International Convention for the Settlement of Investment Disputes
IGSS	Instituto Guatemalteco de Seguridad Social
ILO	International Labour Organization
IMF	International Monetary Fund
INDE	Instituto Nacional de Electrificación
INTECAP	Instituto Técnico de Capacitación y Productividad
IP	intellectual property
IPA	investment promotion agency
IPC	independent project certifier

IPR	investment policy review
IRTRA	Instituto de Recreación de los Trabajadores de la Empresa Privada
IT	information technology
ITU	International Telecommunications Union
kWh	kilowatt-hour
MARN	Ministerio de Ambiente y Recursos Naturales
MCIV	Ministerio de Comunicaciones, Infraestructura y Vivienda
MDG	Millennium Development Goal
MEM	Ministerio de Energía y Minas
MINEDUC	Ministerio de Educación
MINFIN	Ministerio de Finanzas Públicas
MINTRAB	Ministerio de Trabajo y Previsión Social
MW	megawatt
OECD	Organization for Economic Cooperation and Development
PPA	power purchase agreement
PPP	public-private partnership
PRONACOM	Programa Nacional de Competitividad
RGP	Registro General a la Propiedad
RIC	Registro de Información Catastral
SAT	Superintendencia de Administración Tributaria
SIEPAC	Sistema de Interconexión Eléctrica para América Central
SMEs	small and medium-sized enterprise
TNC	transnational corporation
TRIPS	trade-related aspects of intellectual property rights
UNCTAD	United Nations Conference on Trade and Development
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNCITRAL	United Nations Commission on International Trade Law
UNDP	United Nations Development Programme
VAD	valor agregado a la distribución
VAT	value added tax
WEF	World Economic Forum
WEM	wholesale electricity market
WIPO	World Intellectual Property Organization
WTO	World Trade Organization

## GUATEMALA



### Key investment climate indicators

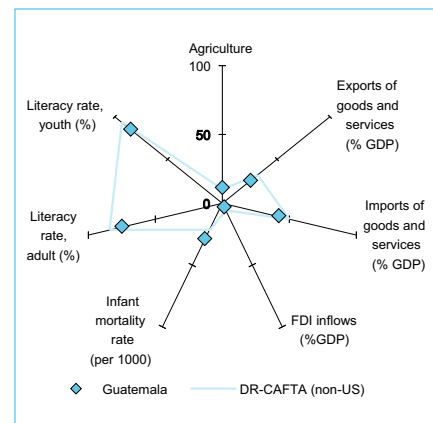
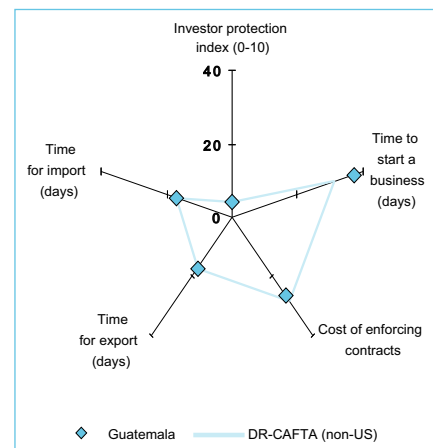
	Guatemala	Costa Rica	El Salvador	DR-CAFTA- (no-United States)
Ease of doing business (rank)	101	125	86	
Time to start a business (days)	37	60	17	31
Cost of registering property (% of property value)	1	3.4	3.8	3.6
Investor protection index (0-10)	4	3	4.3	4.2
Time to pay taxes (hours per year)	344	272	320	284.3
Time to enforce contracts (days)	1459	852	786	832.8
Cost of enforcing contracts (% of claim)	26.5	24.3	19.2	28.8
Time for export (days)	17	13	14	16.3
Time for import (days)	17	15	10	16.8

Sources: World Bank, Doing Business (2011) and UNCTAD (2011).

Indicator	1985-1995 average	1996-2006 average	2009	DR-CAFTA (no-United States) 2009
Population (million)	8.9	11.6	14	48
GDP at market prices (billion dollars)	8.9	20.3	37.3	154.9
GDP per capita (dollars)	987.2	1737.6	2660.7	3223.2
Real GDP growth (%)	3.7	3.5	0.6	0
Gross domestic savings (% GDP)	9.2	6.9	3.3	6.5
Domestic investment (% GDP)	13.3	17.5	15.1	18.1
GDP by sector (%):				
Agriculture	26.7	18.7	12.4	9.8
Industry	20.9	25.2	28.5	29.2
Services	52.4	56.1	59.2	61
Inflation, CPI (%)	18.7	7.4	1.6	3.9
Trade (billion dollars) :				
Merchandise exports	1.3	3.6	7.2	30.6
Services exports	0.4	0.9	1.5	12.8
Merchandise imports	2	6.8	11.5	51.7
Services imports	0.4	1	1.9	8.5
Exports to GDP ratio	26.4	27	23.4	28.8
Imports to GDP ratio	32.5	39.1	33.1	38.3
Capital flows (billion dollars):				
Net FDI flows	0.1	0.3	0.5	5.4
Net flows from private creditors	0	0.3	0.6	0.3
Net flows from official creditors	0	0.1	0.5	2.3
Grants <sup>1</sup>	0.2	0.3	0.6	2.2
FDI to GDP ratio	1.4	1.6	1.5	3.5
Life expectancy at birth (years) <sup>1</sup>	62.6	68.6	70.3	73.1
Literacy rate, adult (%) <sup>1</sup>	64	69	73.8	85.1

Sources: UNCTAD; World Bank, Global Development Finance.

Notes: <sup>1</sup> - most recent data for 2008





## INTRODUCTION

Guatemala is one of the countries in Latin America with the longest FDI attraction record. However, a long internal conflict that lasted for a good part of its contemporary history took a heavy toll on economic and social development and slowed both foreign and domestic investment. The signing of the Peace Accords in 1996 marked the beginning of a new epoch, characterized by renewed macro-economic stability, opening to trade and investment and an unprecedented rise in FDI inflows. Nonetheless, widespread poverty and inequitable income distribution, low education levels and high crime rates continue to hamper the country's social and economic development and prevent Guatemala from realizing its full FDI attraction potential.

Addressing these challenges requires a determined policy effort as well as increased institutional and budgetary capacity to deliver essential services to the population. In this connection, FDI can contribute in major ways to Guatemala's development. This report reviews the different policies that bear an impact on FDI in Guatemala, with a view to recommending concrete policy actions to improve the country's attractiveness and the benefits from FDI throughout the economy and in relation with the strategy sectors identified by the Government.

Chapter I presents an overview of FDI trends and impact since the early stage of FDI in the late 1800s. Today, Guatemala has the potential to become the main hub for FDI in Central America, given its macroeconomic stability, the size of its internal market, a geographical location facilitating trade and competitive labour costs. However, the country has so far failed to attract large inflows of FDI. Indeed, in comparison to other countries in the region, the FDI attraction performance of Guatemala is disappointing. Nonetheless, FDI has had some positive impact on employment, wages, export diversification and the quality of backbone services. The impact of FDI on the establishment of local supplier linkages or technology transfer appears limited.

Chapter II reviews and assesses the investment framework. With minor exceptions, all sectors of the Guatemalan economy are open to foreign investors, who are treated on an equal footing with local investors. Overall, the business climate is characterized by sound legislation and a liberal approach to economic activity. Security is the largest problem affecting potential and existing investment. Modern policies have been adopted over time in areas that include labour, foreign exchange, the environment and intellectual property. Often, however, they are only partially implemented. Tax policy is partly to blame for the low public spending capacity and ensuing institutional weakness of key government agencies. The use of IT facilities has successfully streamlined permitting and other administrative processes in a number of public agencies but the notary function is often overused. Among the key remaining gaps in the investment regime is the lack of a competition policy and agency.

Chapter III analyzes three priority sectors for FDI attraction - electricity, roads and mining - and provides specific recommendations on key institutional, regulatory and investment promotion aspects. The authorities have successfully put in place policies to expand the electricity infrastructure through FDI. Electrification coverage has steadily increased, including in remote rural areas. The only drawback has been the increase in prices driven by several factors including the high reliance on fossil fuels. The Government is now working towards attracting foreign investors to develop the transport network, but efforts in this regard need to be strengthened. There has been only one road concession thus far demonstrating that FDI in this sector is at an "experimental phase". A draft public-private partnership (PPP) law currently being negotiated may open the door to new private investment including in the form of PPPs in the near future. Mining has received some FDI, and potential for further investment is high. However, further investment faces strong resistance from local communities and new policies are needed both to extract much needed fiscal revenue and to more adequately address the environmental and social concerns associated with the sector's development.

Chapter IV summarizes the key findings of the review and presents the main recommendations.





## I. FDI TRENDS AND IMPACT

Throughout its modern history, Guatemala has been open to foreign investment. Since the late 19th century, foreign direct investment (FDI) has entered most economic sectors and profoundly shaped the country's economy. A 36-year internal conflict, however, dampened growth and hindered investment until 1996, when the Peace Accords were signed. Thereafter, political stability, stable macroeconomic management and commitment to market-oriented reforms have led to increased FDI inflows which have continued until our days.

Despite this rise in FDI inflows in the recent past, Guatemala continues to underperform in FDI attraction compared to other developing countries in the region. The FDI potential is nonetheless large and spans across the economy. Guatemala is the largest economy of Central America<sup>1</sup>, benefits from a strategic geographic location as a natural crossing point between South and North America and offers good roads and telecommunications infrastructure that can make it an attractive regional business hub for FDI.

### A. Historical trends

#### 1. Early stage of FDI (late 1800s – 1959)

The FDI history of Guatemala dates back to the late 1800s making the country one of the pioneers in FDI attraction. At this early stage, the agriculture sector was the main recipient of FDI. German investment in coffee production, which accounted for 64 per cent of coffee exports by 1896, was instrumental in consolidating Guatemala's position as a major producer. As commodity exports increased, foreign investment in basic infrastructure to sustain expansion followed. The boom in coffee production led to the development of railroad infrastructure that was financed by investors from the United States of America.<sup>2</sup>

In 1901, the United Fruit Company (UFCO) of the United States of America was first granted a concession to provide all international post services to Guatemala and soon after opened its first banana plantations in the country. Bananas quickly became the second largest export at the expense of coffee. By the 1940s, UFCO was the largest private landowner with 566'000 acres (roughly 16 per cent of total arable land) and the biggest employer with 15'000 workers.

Few foreign companies have shaped a country's history like UFCO in Guatemala.<sup>3</sup> UFCO diversified its investments in Guatemala into railroads, electric utility and telegraph. Through its subsidiary International Railways of Central America, a new line to the Caribbean coast was built and UFCO developed and controlled the port facilities at Puerto Barrios. In some isolated rural areas UFCO operated in, it was the sole provider of housing, health and education. However, UFCO also exacerbated the extremely unequal distribution of arable land which has had profound social implications that endure to this day.

Investment from the United States of America dominated FDI flows during this period, growing from \$6 million in 1887 to \$40 million in 1920. Foreign companies with major investments in Guatemala also included General Electric which acquired Guatemalan electricity distributor Empresa Eléctrica and Goodyear that bought land for the exploitation of rubber in 1957.

<sup>1</sup> Unless otherwise specified, Central America refers to the countries in the isthmus: Belize, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama.

<sup>2</sup> The Nanne-Herrera concession of 1877 granted construction and 25-year operation rights of the railroad line from the port of San José to Escuintla and preferential rights on construction on all future railroads (effective monopoly) to the Guatemalan Central Railroad Company incorporated in California.

<sup>3</sup> Besides owning a large share of the country's arable land, UFCO controlled all major forms of transportation and communications while enjoying a 99-year tax exemption from the Government. The company exerted strong political influence and had favour with corrupt dictatorships. UFCO even lobbied the Government of the United States to destabilize Guatemala's freely-elected Government when it attempted to implement land reforms and a new labour code. As a result, backed by the CIA, the 1954 *coup d'état* took place reinstating right-wing dictatorships in the country. The stronghold UFCO had over Guatemala during 1920-1944 was such that it exemplified the later coined term "banana republic" (servile dictatorship).

## 2. FDI during the Civil War (1960 – 1996)

Guatemala's economy began to industrialize in the 1960s and, for the first time, it attracted significant FDI in manufacturing. The Industrial Promotion Law of 1959<sup>4</sup> and the creation of the Central American Economic Market (CACM), in 1960, set favourable conditions for investment. As a result, FDI in manufacturing rose from \$11.2 million in 1963 to \$42.6 million in 1970. Between 1961 and 1969, the industrial sector averaged an 8.1 per cent annual growth rate, outpacing GDP growth. Yet, this economic development took place behind a background of political and social instability. Reacting to the increasingly autocratic rule of General Ydígoras Fuentes, a group of junior military officers revolted in 1960 marking the beginning of a protracted civil war.

Companies from the United States of America accounted for roughly 80 per cent of total FDI inflows during this period. By 1970, there were over one hundred firms from the United States of America in Guatemala, including Kraft Foods, Eli Lilly, Colgate Palmolive and Texaco. Although the manufacturing sector grew at a rapid pace, most industries imported all raw materials or intermediate goods that were simply assembled in Guatemala. Thus, this industrialization was considered “artificial” as the sector created few business linkages with local suppliers, dramatically increased manufacturing imports and generated little employment growth.

In response, the government took important steps to implement import substitution industrialization (ISI) with the goal of developing a truly domestic industry that could satisfy the demand for manufactured goods. For the first time, the Government of Guatemala actively and directly promoted industrial development breaking with the historically non-interventionist approach. Policies adopted included the capitalization of Banco Industrial in its inception in 1968; the 1971 law to foster small enterprises; and the *Corporación Financiera Nacional* (CORFINA) in 1972 to facilitate financing for industrial ventures in the country.

Domestic private investment was directed towards light manufacturing in food, beverages, textiles, leather and footwear with cement (Cementos Progreso) being the main exception. Meanwhile, a series of internal and external shocks in the 1970s, including a sharp rise in the world price of inputs, the oil crisis and the 1976 earthquake, led to the stagnation of FDI in industry.

The disappointing performance in industrial FDI during the 1970s did not deter foreign investment in agriculture. Favourable world commodity prices and a reduction in trade barriers for some key products led to a tripling of cotton output, a doubling of sugar, and a 50 and 25 per cent increase in coffee and livestock production respectively. Also, cardamom, first introduced by Germans in Alta Verapaz, experienced rapid growth and became the third most valuable export by 1978.

In addition, the extractive industries started attracting some FDI during this period, more specifically in mining for nickel and in oil production. Exploraciones y Explotaciones Mineras Izabal (Exmibal), a Canada-United States consortium, operated from 1960 to 1980.<sup>5</sup> After five years of exploration, the company received an exploitation concession from the government and built a nickel extraction plant in Izabal worth \$238 million. Throughout the 1960s, several companies from the United States of America (e.g. Texaco, Amoco, Esso, etc.) received exploration concessions and drilled wells. However, by the mid 1970s two companies consolidated their positions as the major oil producers: Shenandoah Oil of the United States of America and Canadian Centram.<sup>6</sup>

<sup>4</sup> Law 1317 of 1959 virtually eliminated all restrictions on foreign investment and extended investment incentives to companies that imported all inputs and simply assembled them in Guatemala.

<sup>5</sup> Exmibal was composed by M.A. Hanna Company of Cleveland and International Nickel Company of Canada (INCO) with 20 per cent and 80 per cent interest in the company respectively.

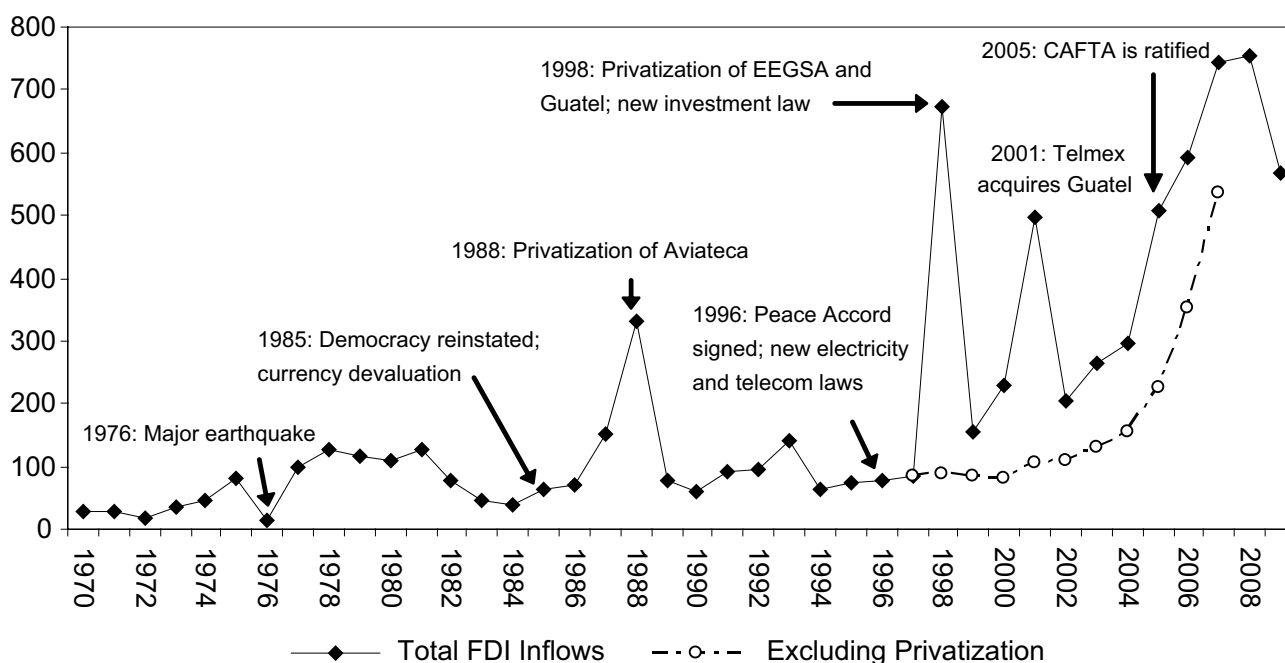
<sup>6</sup> Decree-Law 96-75 changed the modality of concessions (of up to 40 years) for that of exploration and exploitation contracts which were less attractive to foreign investors. As a result, only Shenandoah which had access to the only viable oil field (Rubelsanto) at the time, and Centram (a wholly owned subsidiary of INCO) remained in Guatemala after 1976.

Serious macroeconomic shocks affected the Guatemalan economy again in the 1980s plunging it into recession. High global interest rates made it more difficult for countries to honour their debt payments. The quetzal depreciated and while oil prices were high, the price of coffee, the country's main foreign exchange earner, began to fall. At the same time, violence from the ongoing armed conflict escalated affecting the investment climate.<sup>7</sup> The Latin American debt crisis and the worsening political instability that saw two coups take place in a span of two years (1982-1983), caused mass capital outflow from Guatemala and a fall in FDI inflows.

The economy began to recover after two years of recession with the creation of the Caribbean Basin Initiative (CBI) in 1984, which extended preferential access for Guatemalan products to the United States market. Real GDP growth rates started to pick up going from 0.5 per cent in 1984 to 3.9 per cent in 1989. Moreover, a new Constitution was ratified and democracy reinstated in 1985. State-owned airline Aviateca was privatized in 1989; 45 per cent of its share were sold to a group of Guatemalan investors and 30 per cent to Salvadoran-based TACA. That same year, Congress passed new free zone and maquila laws providing generous incentives for foreign investors in export manufacturing (figure I.1).

The World Bank extended a \$120 million structural adjustment loan to Guatemala in 1992 that required the country to adopt market-oriented reforms. This set the stage for an improved investment climate with new electricity and telecommunications laws passed and the signing of the first bilateral investment treaty (BIT) with Chile in 1996. In addition, the government put an end to decades of internal conflicts with the 1996 Peace Accords that marked a definitive turning point in Guatemala's history.

**Figure I.1. FDI inflows to Guatemala, 1970 - 2009**  
(Million dollars)



Source: UNCTAD FDI/TNC database and Banco de Guatemala.

<sup>7</sup> The burning of the Spanish Embassy in Guatemala City (31 January 1980) is considered to be the defining event in the protracted civil war. A group of K'iche' and Ixil peasants occupied the Embassy to protest the kidnapping and murder of peasants in Uspantán by elements of the Guatemalan Army. The subsequent police raid resulted in a fire which destroyed the Embassy and left 36 people dead.

### 3. FDI in the post-Civil War era (1997 – 2009)

Continued political and economic stability and moderate GDP growth rates (averaging 3.9 per cent in the post-Civil War era compared to 4.4 per cent for Central America), have yielded increased FDI inflows since 1997 (figure I.1). Guatemala's performance in attracting FDI over the last decade has been the best in its history.

The privatization process is responsible for a large portion of FDI inflows in recent years, particularly in the electricity and telecommunication sectors. The sale of the public electricity company EEGSA, for example, accounted for 77 per cent of FDI inflows in 1998. Meanwhile, the public telecommunications provider, Guatel, was initially sold to a consortium of local investors, before Mexican Telmex acquired 84 per cent of it two years later.

Excluding privatizations, FDI inflows began to pick up in other sectors such as food and beverages, textiles, retail and mining (section "Sector trends" and figure I.II). Various factors contributed to the rapid rise in FDI, including: 1) the adoption of the 1998 investment law;<sup>8</sup> 2) the liberalization of foreign exchange in 2001; 3) the creation of the investment promotion agency "Invest in Guatemala" and the "Programa Nacional de Competitividad – PRONACOM" in 2004; and 4) trade liberalization. After joining the World Trade Organization (WTO) in 1995, Guatemala began to negotiate a series of free trade agreements (FTAs) with major trading partners. These include multilateral FTAs with Mexico, Honduras and El Salvador through the Northern Triangle agreement (2001), as well as with the United States of America and other regional countries through the Dominican Republic – Central American Free Trade Agreement<sup>9</sup> (DR-CAFTA) (2005). In addition, Guatemala concluded bilateral FTAs with Taiwan Province of China (2006), Panama (2009) and most recently Colombia (2009). All these agreements, that usually include a comprehensive chapter on investment protection, have encouraged foreign investment by guaranteeing market access and intellectual property rights.

### 4. Opportunities and challenges

Despite the current global crisis, FDI prospects in Guatemala look promising. Given the size of the market, the largest in the region with a population close to 14 million, and its geographical location, the country has the potential to attract more FDI so as to develop a regional business hub exporting to Central America and southern Mexican states. Many investors have recently set up operations in Guatemala with this objective in mind. Guatemala also has the largest workforce in Central America estimated at 4.1 million and number of annual university graduates at 176 thousand.

The stable and prudent macroeconomic management since 1996 is also an asset in the eyes of investors. Guatemala has the fourth lowest debt to GDP ratio in Latin America and has never defaulted on its payments. The government's deficit is relatively low estimated at 3.4 per cent of GDP for 2009 (IMF, 2010), while the country's ratings (Fitch BB+, Standard and Poor's A2) remain stable.

Compared to most countries in the region, Guatemala offers a well diversified economy. The manufacturing sector is reasonably developed and there is potential for local suppliers to integrate into international value chains. However, local industry needs modernization to establish business linkages with TNCs and reap the benefits from trade liberalization. Future FDI can also become a driving factor in the development of new sectors that would further diversify and strengthen the economy. There are already some examples of how FDI relying on external demand has contributed to the growth in services (business processing outsourcing (BPO), and call centres) and other niche industries (ornamental plants, box I.2).

<sup>8</sup> The 1998 investment law, which is still in place today, was instrumental in opening the economy to FDI (chapter II).

<sup>9</sup> The DR-CAFTA has been ratified by the Dominican Republic, El Salvador, Costa Rica, Guatemala, Honduras, Nicaragua and the United States.

While Guatemala shows a clear potential and offers business opportunities for higher FDI inflows, several challenges need to be addressed in order to translate investment into development. These include high poverty levels marked by acute income inequalities, high levels of crime and insecurity as well as a weak education system. Guatemala, with a Gini coefficient of 53.7<sup>10</sup>, is ranked among the top twenty countries with most unequal income distribution in the world (UNDP, 2009). The wealthiest 20 per cent of the population receive two-thirds of all income and many households rely on remittances from abroad.<sup>11</sup> Furthermore, two per cent of the population own 72 per cent of the agricultural land.

In Guatemala, 51 per cent of the population is poor; more than 35 per cent lives below the national poverty line (\$2 a day) and about 15 per cent below extreme poverty (\$1 a day).<sup>12</sup> Poverty is concentrated in rural areas, where most of the indigenous people live and work in the informal sector. Malnutrition and hunger, a direct result of poverty, is of grave concern as the country is the second worst performer in the western hemisphere after Haiti and is categorized as a serious case country.<sup>13</sup>

Common and violent crime, aggravated by a legacy of violence and “vigilante” justice is another obstacle to development and is one of the top deterrents to new FDI. Guatemala has one of the highest violent crime rates in Latin America (chapter II). A 2003 World Bank survey showed that 80.4 per cent of managers ranked crime as a major business constraint, the highest for any country. The survey also found that 73.1 per cent of managers lacked confidence on courts to uphold property rights, reflecting deficiencies in the judicial system.

Shortcomings in education limit the availability of skilled labour, which should be far greater considering the size of the population. Education expenditure as a share of GDP in Guatemala was 3.1 per cent, below the Latin American average of 4.1 per cent in 2007. Furthermore, enrolment in secondary and tertiary education remains low (chapter II). Also, the fact that indigenous children continue to receive disproportionately less education is worrying.<sup>14</sup> All these problems are further exacerbated by the low spending capacity of the government that hampers the provision of essential health and education services (chapter II, section on taxation). Tax revenue as a percentage of GDP is the lowest in the region at 9.9 per cent, compared to El Salvador (13.9 per cent), Costa Rica (15.2 per cent), Honduras (16.4 per cent) and Nicaragua (19.4 per cent).<sup>15</sup>

Finally, economic integration through DR-CAFTA may also have negative repercussions on some local industries that fail to reach higher standards to compete internationally. DR-CAFTA levels the playing field for all other signatories competing for the same pool of investors. Furthermore, market access is reciprocal and investment in local industry modernization will be necessary to reap the benefits from trade liberalization. DR-CAFTA itself is unlikely to lead to substantial development gains without parallel institutional and regulatory reforms as well as improvements in infrastructure and education.

## 5. Comparative FDI trends

Since 2005, Banco de Guatemala, the central bank, started a process of official FDI data collection, by means of the *Encuesta Anual del Sector Externo*, a voluntary survey covering all enterprises listed in the Banco de Guatemala database. The Banco de Guatemala also uses information obtained from commercial banks on access to foreign exchange (*balanza cambiaria*) for large operations in foreign currency to support

<sup>10</sup> The Gini index lies between 0 and 100. A value of 0 represents absolute equality and 100 absolute inequality.

<sup>11</sup> The Banco de Guatemala estimates that remittances totalled \$3.9 billion (10.5 per cent of GDP) in 2009.

<sup>12</sup> The Encuesta Nacional de Condiciones de Vida (ENCOVI) 2006, defines the national poverty line at Q6,574 a year (about \$2 a day) and extreme poverty at Q3,206 a year (about \$1 a day).

<sup>13</sup> The International Food Policy Research Institute (IFPRI) developed the global hunger index (GHI) which takes into consideration the percentage of undernourished in the population, the percentage of underweight children under five and the mortality rate of children under five. As such, Guatemala ranks 32 out of 129 developing countries and falls as a serious hunger case country in a five-category scale: low, moderate, serious, alarming and extremely alarming.

<sup>14</sup> According to the Ministerio de Educación (MINEDUC), whilst 36.5 per cent of children inscribed in primary school are indigenous, by the time students reach high school only 12.9 per cent of them are indigenous.

<sup>15</sup> Estimate for Guatemala is from Banco de Guatemala, for other countries it comes from the World Bank.

survey results (which does not take into account inter-company loans). However, official FDI data most likely underestimates inflows. The survey is far from comprehensive and many large foreign investors interviewed during the UNCTAD fact-finding mission reported never having received the survey in the first place. Central bank personnel interviewed by UNCTAD estimated a 60 per cent response rate on surveys.

Notwithstanding the data limitations, Guatemala appears to significantly underperform in comparison to 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 DR-CAFTA average and well below that of Chile or Panama (above \$600 per person), the best performers in 2006-2009 (table I.1). The same is true of FDI per \$1'000 GDP and as a per cent of gross fixed capital formation (GFCF) where Guatemala comes in last with \$19 and 10.5 per cent, respectively. Guatemala's FDI stock corresponded to only 16 per cent of GDP in 2009, below all regional comparators. Thus, there is definitely room for improvement as Guatemala is below the average performance of CAFTA developing countries which are direct competitors for investment from the United States of America in the region. Guatemala's growth rate has been insufficient to catch up as other countries in the region have grown faster.

The government has set a goal to attract \$1.5 billion in annual FDI inflows by 2013. To accomplish this, Guatemala will have to sustain an average annual growth rate of 25 per cent in FDI inflows from 2008 onwards. This will be a difficult task considering that FDI inflows for 2009 fell by around 25 per cent from the previous year due to the global financial crisis. This setback may jeopardize Guatemala's objective whose success will rely on a quick global recovery and continued improvement in the investment climate.

**Table I.1. Comparative FDI flows in selected countries, 1991-2009**  
(Dollars and percentage)

ABSOLUTE PERFORMANCE				RELATIVE PERFORMANCE															
Country	Average FDI inflows per year			FDI Stock	Average FDI inflows per year					As per cent of GFCF					FDI Stock				
	Millions of dollars				Per \$ 1000 GDP					Per capita (dollars)					Per capita (\$)	% GDP			
	1991-1995	1996-2000	2001-2005		2006-2009	1991-1995	1996-2000	2001-2005	2006-2009	1991-1995	1996-2000	2001-2005	2006-2009	1991-1995			1996-2000	2001-2005	2006-2009
Guatemala	93.5	243.7	354.3	664.1	5989	9.8	22.7	29.5	49.6	9.3	14.5	15.9	19.0	5.4	7.5	8.6	10.5	431.4	16.0
Costa Rica	257.1	494.7	669.9	1'677.2	12'141	77.2	131.9	159.8	372.9	26.8	35.2	37.2	62.7	13.9	19.2	19.8	28.9	2'639.2	41.4
Dominican Republic	227	701.5	928.1	1'944.1	13'303	30.3	86.5	107.4	210.3	17.4	32.9	37.4	45	11	16.7	22.4	26.1	1'415.5	28.5
El Salvador	19.4	309.4	353	741.1	7'132	3.6	50.9	53	103.4	2.8	25.5	23	35.7	1.6	15.3	14.1	23.3	970.8	33.8
Honduras	52.5	187.1	425.7	749.3	5'841	9.9	30.1	61.3	98.8	14.5	29.3	49.4	58.8	6.2	11.1	20.3	20.1	745.1	40.5
Nicaragua	47.9	206.1	209.3	432.2	4'190	11.2	42.9	39.6	74.6	15.7	56.5	48.3	73.5	8.2	20.7	18.4	24.9	704.2	68.1
<b>DR-CAFTA</b>	697.5	2'142.5	2'940.4	6'208	48'591	19.7	54	67.2	130.1	14.9	28.9	31.3	43	8.3	14.5	16.7	21.8	991.4	31.4
Bolivia, Plurinational State of	169.2	811.3	275.5	395.7	6'421	23.3	101.3	32.4	41.1	27.7	99.2	35.3	26.9	17.8	51.5	24.3	16.8	651	37
Chile	1'666.1	5'667	5'042.7	11'928.8	121'640	118.4	376.7	314.9	712.2	29.9	74	58.3	73.2	12.3	31.7	28.3	34.3	7'168.1	74.5
Colombia	911.9	3'089.4	3'932.7	8'372.3	74'092	24.4	76.4	87.8	177	13.5	31.3	33.3	40	6.4	17	17.1	16.2	1'534.7	32.8
Panamá *	209.4	896.5	643.9	2'112.2	18'675	81	316	204.2	627.8	25.2	83.8	46.6	103.2	14.7	39.6	28.4	49.5	5'406.8	75.9
Malaysia	5'063.6	4'803.4	2'983.7	5'824.4	74'643	261.5	221.2	120.9	221.4	76.4	52.5	25.3	31.2	19.7	16.8	11.6	15	2'753.5	39
Mauritius	17.1	86	24.3	271.1	1'889	15.6	73.2	19.7	212.7	5.1	19.3	4.1	33	1.8	8.1	1.9	13.3	1'466.5	21.8
Sri Lanka	123.1	218	220.4	559.9	4'686.6	6.7	11.2	10.8	26.5	11.6	14.2	11.4	15.9	4.6	5.6	5.3	6.4	219	11.2
<b>Developing economies</b>	77859	202'678	239'367	526'914	4'893'490	18.1	43.1	47.4	98.1	15.7	31.1	28.6	34.4	6.4	13.1	11.6	12.2	893.5	29.1

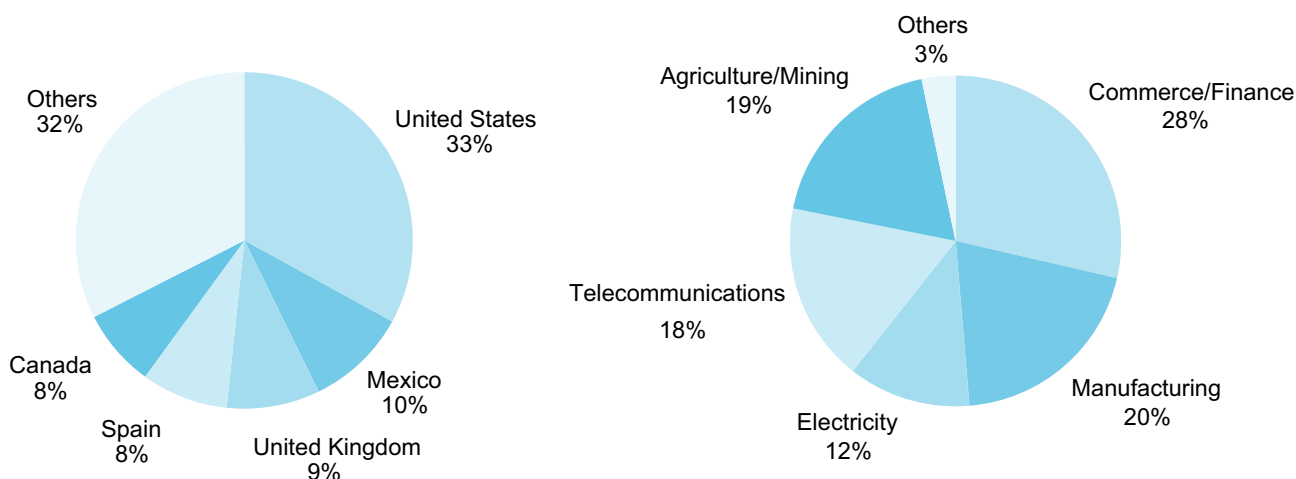
Source: UNCTAD, FDI/TNC Database (WIR10), Globstat. Note: (\*) data in italics are estimates.

## B. FDI by country of origin and by sector

Although the origin of FDI has diversified, investment from the United States of America still leads by far accounting for more than 30 per cent of total FDI inflows (figure I.2). Companies from the United States of America operate in many sectors, including major investments in: retail (Wal-Mart, PriceSmart), agriculture (Monsanto), manufacturing of consumer goods (Kimberley-Clark, Procter and Gamble), pharmaceuticals (Pfizer), food (Del Monte, Dole) and energy (Duke). Mexican investment is mainly in telecommunications (Telmex/América Móvil), cement (Cemex), food and beverages (Bimbo, Gruma, Lala, Femsa), and on the first (and only) toll road operation (Marnhos).

The FDI portfolios of other important origin countries are not as diversified. Spanish FDI is predominantly in electricity (Unión Fenosa, Iberdrola), telecommunications (Telefónica) and tourism (Barceló). Canadian firms concentrate in mining. Meanwhile, FDI from the United Kingdom is mostly in consumer goods (Unilever). Investment coming from other countries has been less sustained and more volatile.

**Figure I.2. FDI inflows by country of origin and by sector, 2007 - 2009**  
(Percentage)



Source: Banco de Guatemala.

Aside from the investment that resulted from the privatization of utilities, there is a strong presence of FDI in the manufacturing and commerce and finance sectors (figure I.2). Within the manufacturing sector, food and beverages is the largest component accounting for 39 per cent, followed by textile production with 23 per cent and metals with 19 per cent in 2007-2009. Meanwhile, in the commerce and finance sector, FDI growth has been driven by recent investment in banking. There is FDI to a lesser extent in agriculture and mining while the share of inflows to other activities remains low but has experienced steady growth in recent years, particularly for services.

### I. Manufacturing

The manufacturing sector is well diversified and is the main recipient of FDI. It has attracted important investments in food and beverages, metallurgy and textiles, particularly those operating under the special maquila regime and the free trade zones (FTZs).

The food and beverage sub-sector is well established and has a long FDI history. Noteworthy developments in the past decade are the expansion of Mexican Bimbo Group which purchased La Mejor, producer of baked-goods, and Nestlé which bought dairy producer Fonterra Cooperative in 2001. However,



### Box I.1. FDI in the free trade zones and maquila regime

The first FTZ in Guatemala is the Zona Libre de Industria y Comercio de Santo Tomás de Castilla (ZOLIC). It was created under a special legal status exempting it from all trade duties in 1979 to develop the country's Atlantic coast as a logistic and commercial centre. In 1989 a new law (Decree 65-89) was passed to extend these fiscal benefits. Today, there are 18 FTZs in operation under this law and 25 more in the development stage. The entire FTZ regime comprises some 220 companies which employ 6'000 people directly and an estimated 500'000 indirectly.

Out of the existing 18 FTZs, five are actual physical zones managed by the Zeta Group of Italy while the others are simply companies that enjoy the special status. Before 1996 FTZs attracted little FDI; currently an estimated 70 per cent of companies under the regime are foreign-owned.

Guatemala was one of the first countries in the region to diversify its FTZs away from textile production. Between 1997 and 2004, 80 per cent of all economic activity taking place in FTZs was in textiles and garments. Today, the sector represents 40 per cent as pharmaceuticals, plastics, BPO and call centres all have gained importance.

Aside from FTZs, Guatemala has a maquila regime with similar benefits under Decree 29-89 (chapter II). As of October 2009, there were 704 companies listed under the special regime of which 197 were foreign and 49 of mixed local-foreign capital. The main foreign investors come from the Republic of Korea (mostly in textiles), the United States of America and Mexico. After textiles, the leading industries benefiting from this regime are agriculture, food processing, plastics and chemicals.

The maquila sector, which targets its exports mainly to the United States market, has been directly affected by the ongoing global economic crisis. In 2008, the entire maquila regime generated an investment of \$179.6 million (down 51.5 per cent from the previous year). Likewise, employment declined as the number of workers went from 20'625 in 2007 to 17'042 in 2008.

Source: UNCTAD and interviews.

in dairies, most inputs are imported due to high cost of local milk. In addition, Florida Ice and Farm of Costa Rica acquired the operations of Kern's of the United States of America in fruit juices and nectars for a reported \$86 million in 2006, and more recently, Grupo Lala of Mexico obtained Foremost Dairies in 2008. Other major agro-manufacturing firms present in Guatemala are Kraft Foods, Del Monte (Bandegua), Dole, Campbell's and Gruma (Maseca).

In the 1990s, two soft-drink bottling plants were sold to foreign investors: Embotelladora Central to Panamerican Beverages (Panamco) for \$62.3 million in 1998 and Embotelladora del Pacífico to a British investor group for an undisclosed amount in 1994. In 2003, FEMSA of Mexico bought Panamco for \$3.6 billion and became the second largest Coca-Cola bottling company in the world. That same year, Brazilian Ambev (now merged with Belgian Inbev) invested \$50 million to open a brewing plant in Guatemala and an additional \$10 million during the first year of operations; 40 per cent of the plant's output is exported to neighbouring countries.

The Guatemalan tobacco industry is dominated by FDI. There are two large cigarette manufacturers focused on distribution: British American Tobacco (BAT) and Phillip Morris through its wholly-owned subsidiary Tabacalera Centroamericana S.A.

Despite its decline, the textile and apparel industry remains a key component of the Guatemalan manufacturing sector as it is a net-exporter and important source of employment. Whilst most thread and fabric manufacturing is done by local firms, the majority of apparel confection (sewing and cutting) is foreign-owned. FDI from the Republic of Korea leads apparel production controlling 89 out of 155 registered clothing enterprises in 2009,<sup>16</sup> the majority of which operate under the maquila regime (box I.1). Roughly 90 per cent of textile output is exported to the United States of America. The Guatemalan textile industry aims to move towards higher value-added garments focusing on marketing to middle and high segments of the United States market as it is being displaced of the lower-end market by Asian imports.<sup>17</sup>

Lastly, the metallurgy industry has received significant FDI in recent years. Steel Holdings of America acquired Galvanizadora Centroamericana (GALCASA) in 2007, where Mitsubishi Corporation had a majority interest. Brazilian steel manufacturer Gerdau also purchased a 30 per cent interest in Corporación Centroamericana del Acero, the largest steel-maker in the region, in 2008. Gerdau has committed to invest \$180 million in its Central American operations.

## 2. Banking and finance

FDI in banking has only entered in the last few years. The sector remains mostly in the hands of local private investors as the top four commercial banks, all domestic, control 72.8 per cent of the market.

The first foreign bank to receive a banking licence was Banco Azteca. This Mexican commercial bank, specialized in micro-credit, was given authorization to operate in Guatemala in 2006 and opened its offices a year later.

Citibank entered the Guatemalan market after it absorbed two regional financial groups in 2007: Grupo Cuscatlán and Grupo Financiero Uno. Grupo Cuscatlán, which included Banco Cuscatlán de Guatemala, the sixth largest bank in the country, was acquired for a reported \$1.5 billion. Meanwhile, Grupo Financiero Uno, the largest credit-card issuer in Central America which included Banco Uno Guatemala, was purchased for \$2.1 billion. These two banks were merged with Citibank N.A.'s local branch to form Citibank de Guatemala.

For its part, Scotiabank of Canada entered the market after acquiring a small local bank,<sup>18</sup> Banco de Antigua for an undisclosed amount in February 2008. At the time of the acquisition, Banco de Antigua had 47 branches, 160'000 clients, and about \$82 million in total assets, representing only a 0.5 per cent market share.

The latest newcomer is HSBC which applied for a banking licence in April 2008 but finally opted to open a commercial representation office in October 2009. The office will allow Guatemalan clients to open dollar accounts in the Miami branch and access offshore loans. HSBC does not rule out buying a local branch or opening a commercial subsidiary in the future.

Banco de América Central (BAC), the eight largest bank in Guatemala, is a regional bank that operates in all six Central American countries with the holding company headquartered in Panama. GE Capital Global Banking first purchased 49.9 per cent of BAC in 2005 and increased its stake in the bank to 75 per cent in June 2009. The amounts paid for the transactions were not disclosed.

<sup>16</sup> By comparison, there are 10 United States, one French and 55 Guatemalan apparel firms registered.

<sup>17</sup> Textile production in Guatemala peaked in 2004 when it employed over 113'000 people and generated close to \$2.5 billion in exports to the United States. Since then, it has declined in large part due to the expiration of the Multi-fibre Agreement (MFA) in 2005 that liberalized the United States market to Asian countries, particularly China.

<sup>18</sup> Originally, Scotiabank had tried to purchase Bancafé, Guatemala's fourth largest bank, but Bancafé was closed down by the Superintendencia de Bancos for failing to meet capital-adequacy requirements in 2006. Some analysts pointed out that after this failed attempt, Scotiabank purchase of a small bank came as a strategic move to enter the market without having to wait through the long process of applying for a banking licence.

There are also three foreign insurance companies in Guatemala. Seguros Panamericana, the fifth largest insurer with an 8.1 per cent market share, is a wholly-owned subsidiary of Pan-American Life Insurance (United States of America). Mundial Desarrollo de Negocios of Panama acquired 99 per cent of Aseguradora de la Nación and bought Guatemalteca Cigna de Seguros for \$6.9 million in 2007. Finally, Generali Group is the oldest foreign insurer with operations in Guatemala since 1968.

### 3. Electricity

Prior to privatization, the state-owned Empresa Eléctrica de Guatemala (EEGSA)<sup>19</sup> and the Instituto Nacional de Electrificación (INDE), which assumed control over all hydroelectric plants in the country, provided all electricity services. The 1996 General Electricity Law sought to end the state's monopoly opening the sector to private investment though it prohibited investors from engaging simultaneously in generation, transmission and distribution under the same company (chapter II).

Initially, FDI entered the sector through several private generation contracts in the early 1990s. The first was Puerto Quetzal Power (PQP) in 1992, a bunker-fired thermal plant currently operated by Ashmore Energy International (AEI).<sup>20</sup> After the electricity law of 1996, EEGSA decided to sell 90 per cent of its generation facilities to private investors. As a result, 65 per cent of total generation today is in private hands and roughly 40 per cent correspond to FDI (table I.2). There are 30 generation companies of which only INDE remains government-owned. It is the largest generator, responsible for 35 per cent of total supply.

**Table I.2. Major foreign-owned generation companies, 2008**  
(Megawatts and gigawatts per hour, percentage)

Generator	Parent company		Installed capacity*		Total generation	
	Name	Country	MW	Per cent	GWh	Per cent
San José	TECO	United States of America	139	5.9	1'016.6	12.8
Duke Energy <sup>21</sup>	Duke Intl.	United States of America	295	12.5	975.5	12.2
PQP/Poliwatt	AEI	Cayman Islands	247.4	10.5	532.7	6.7
COMEGSA	Iberdrola	Spain	113.9	5.6	417.5	5.3
GENOR	ConEdison	United States of America	46.2	2.3	192.3	2.4
SUM			841.5	35.6	3'134.6	39.4
<b>TOTAL</b>			<b>2'365.3</b>	<b>100</b>	<b>7'922.1</b>	<b>100</b>

Source: Administrador del Mercado Mayorista (AMM).

Note: (\*) Installed capacity estimates as of June 2009, generation estimates are for 2008.

Following the sale of its generation assets, EEGSA remained predominantly an electricity distributor. In 1998, a consortium of investors<sup>22</sup> led by Iberdrola Energía of Spain acquired 80 per cent interest in EEGSA for \$520 million. Likewise, INDE opened a public bidding for the remaining two distribution companies in the country: Distribuidora Eléctrica de Occidente (DEOCSA) and Distribuidora Eléctrica de Oriente (DEORSA). In 1999, Unión Fenosa of Spain acquired an 80 per cent stake in each company for a reported \$101 million. Iberdrola protested the Government's decision to lower tariffs aimed at reducing costs of energy for lower income households and presented a claim against Guatemala at ICSID in 2008 (chapter II).

<sup>19</sup> Foreign investors developed and administered Guatemala's electricity system in its early stage. American General Electric obtained a fifty-year monopolistic concession in 1922 and, when the contract expired, the electricity company was nationalized and EEGSA was created.

<sup>20</sup> PQP was a joint venture owned by United States Enron and local Centrans Energy Services that was later sold to Cayman Island-based AEI in 2007 for an undisclosed amount.

<sup>21</sup> In 1997, Guatemala Generating Group (GGG), a company of Constellation Energy Group of the United States, acquired two large thermal plants (Laguna and Stewart and Stevenson) in a public bidding for \$30 million before they were sold to Duke in 2001. Since then, the company from the United States has expanded its operations by acquiring other thermal plants.

<sup>22</sup> The consortium was composed of Iberdrola (49 per cent), Electricidade de Portugal (21 per cent) and TECO Energy (30 per cent).

Although there are four companies involved in transmission, the private sector still plays a minor role. The public ETCEE, a subsidiary of INDE, is responsible for most electricity transmission in the country. The private companies operating in transmission are Iberdrola's subsidiary TRELEC, Union Fenosa's RECSA and Duke Energy. In December 2009, however, the Government concessioned the construction and operation of an additional 843 km of transmission lines to the Colombian consortium composed of Empresa Eléctrica de Bogotá and Empresa Eléctrica de Medellín (EEB-EDM) for an estimated investment of \$400 million. Finally, there are 18 supply companies all of which are private.

#### 4. Telecommunications

The Empresa Guatemalteca de Telecomunicaciones (Guatel) was established after Tropical Radio and Telegraph Company (TRT), a subsidiary of UFCO, was nationalized in 1966. No private investment in the sector occurred until 1989 when Comcel, a consortium led by Luxembourg-based Millicom International, managed to get a concession in mobile telephony that effectively extended to a ten-year monopoly.<sup>23</sup> Aside from this exception, Guatel served as the single telecommunications provider until 1998 when it was privatized.

The 1996 General Telecommunication Law paved the way for privatization splitting the state monopoly into two companies: Guatel that would remain a public company to provide telecommunication services for government agencies, and the new Telgua that would be completely privatized. After an opaque process,<sup>24</sup> Telgua was finally acquired with a \$700 million bid by Luca Group, a consortium of mostly local investors. Soon after, Telmex acquired 84 per cent of Telgua for \$541.8 million in 2001, the largest single foreign investment in Guatemala to date.

In mobile telephony, the entry of Mexican América Móvil (part of Telmex) and Telefónica of Spain in 1999 broke Comcel's monopoly. That same year, Millicom International increased its share in Comcel from 47 to 55 per cent. The incumbent mobile company began to market itself under Millicom's international brand Tigo. In 2001, Bellsouth of the United States of America entered the market but Telefónica acquired its operations in Guatemala for \$175 million in 2004. As such, the market is currently distributed between América Móvil-Claro (37.3 per cent), Comcel-Tigo (37.2 per cent) and Telefónica-Movistar (25.6 per cent).

Although there are 15 fixed-line telephone operators, the market is highly concentrated in part due to the nature of high fixed costs in providing this service, and studies suggest that there has been abuse of dominant position (González, 2007). The incumbent Telgua (Telmex) has an 82 per cent market share<sup>25</sup> followed by Telefónica (12 per cent), and Tigo (4 per cent); the latter two only service business clients. Telgua has also taken advantage of its dominant position to gain control over 73 per cent of internet broadband services in the country. In addition, there are 17 international portal operators that have yielded competitive prices on international calls.

Recently, FDI has also entered the television broadcasting market. Television Azteca of Mexico purchased 70 per cent of Guatemalan television broadcasting station Latitud TV for an undisclosed amount in 2008. TV Azteca recently announced that it would invest \$8 million to acquire transmission licensing.

<sup>23</sup> After granting the concession, several high-level Government officials were accused of having a personal interest in this unusual deal.

<sup>24</sup> The Government first attempted a public auction in 1997 when five international companies met the preliminary qualifications. Only Telmex made a bid that was finally deemed unacceptable. A year later, a second attempt took place and two companies, Deutsche Telecom and Luca Group, presented themselves to the auction (it was announced just a day before). Luca Group qualified for the auction even though it was not a telecommunications operator. A change in the rule was adopted only two days before the auction to allow its bid.

<sup>25</sup> Telgua acquired Sercom in September 2008 and as such the 14 per cent market share of the second largest fixed-line provider is now part of Telgua's share. Cablenet, with a 6 per cent market share and originally a joint venture between France Telecom and CTE Telecom of El Salvador, was also acquired by Telmex.

## 5. Mining and oil

Mining continues to represent a small share of total FDI. Despite high potential and some investment in the extraction of nickel and gold, the sector continues to underperform in part due to the opposition from local communities and the sensitive issue of land distribution and exploitation in the country (chapter III).

There are currently 11 foreign companies in the mining sector, mostly in exploration. The sector is dominated by Canadian FDI and concentrated in the extraction of gold and silver. These two precious metals accounted for 96 per cent of the value of total mining output in 2007, all of which was for export.

Canadian Goldcorp consolidated itself as the largest mining company in Guatemala through the acquisition of Glamis Gold of the United States of America for \$8.6 billion in 2006. The Goldcorp's Marlin project, in operation since 2005, is the leading gold mine in Guatemala where the company has invested over \$200 million. In addition, Goldcorp expected to begin extraction as early as 2010 at its second mine, Cerro Blanco, where it has already invested \$77 million.

Aside from gold, nickel is the second most important commercial mineral in Guatemala. One of the 10 largest known nickel deposits in the world is located at lake Izabal. In 2004, Canada's Skye Resources bought 70 per cent of INCO which held an 80 per cent interest on Exmibal (section on historical trends), and secured a 25-year exploitation concession from the Government in 2005 with view to reopen the nickel mine named Project Fenix. Hudbay, another Canadian company, acquired Skye Resources in 2008 and took control of the Project Fenix and Compañía Guatemalteca de Níquel (CGN), the local subsidiary. At the moment, Hudbay is refurbishing and upgrading the existing facilities hoping to begin extraction, yet opposition from the local community coupled with the financial crisis have delayed the plan.

Other foreign companies in mining include El Condor Resources of Bahamas with three subsidiary firms in Guatemala and the Canadian companies Gifford, Tombstone Exploration, Aurora Gold and Mayaniquel. The latter is owned by Anfield Nickel Corporation of Canada which bought BHP Billiton companies Mayaniquel and Jaguar Nickel in 2008.

**Table I.3. Market share of fossil fuels imports and distribution, 2008**  
(Million barrels, number of stations and percentage)

Name	Origin	Fossil Fuel Imports		Service Stations	
		Million barrels	Per cent	Stations	Per cent
Shell	United Kingdom/ Netherlands	4.97	32.6	174	12.7
Puma Energy	Netherlands	3.01	19.7	20	1.5
Esso	United States of America	2.45	16	99	7.2
Chevron/Texaco*	United States of America	2.37	15.6	111	8.1
Blue Oil	United Kingdom	1.1	13.1	-	-
Petrolatina	United Kingdom	0.45	2.9	-	-
Other				970	70.5
<b>TOTAL</b>		<b>15.25</b>	<b>100</b>	<b>1'374</b>	<b>100</b>

Source: Ministerio de Energía y Minas (MEM).

Note: (\*) Chevron sold its gasoline service stations to Shell for \$29 million in 2003. Since then, all distribution is done by Texaco (acquired in 2001) while imports and supply is still done by Chevron.

Although Guatemala is the only oil producer<sup>26</sup> in Central America, it is a net energy importer. The country imports almost all fossil fuels for consumption to meet demand while most of domestic production is for export. Oil production is dominated by the Anglo-French Perenco that acquired Anadarko's operations for \$120.5 million in 2001. Perenco's chief assets in Guatemala are the producing Xan field in northern Petén, a refinery at La Libertad, an Atlantic coast terminal at Piedras Negras and a 475 km pipeline connecting the

<sup>26</sup> Total crude oil production in 2008 was 5.2 million barrels (bbls) or 15,299 bbls/day, down by 7.6 per cent from 2007. Guatemalan oil production peaked in 2003 when production was close to 25'000 bbls/day. Over 90 per cent of oil production comes from the Xan field operated by Perenco.

three. Other foreign firms in oil production are Petro Energy (British Virgin Islands), Petrolatina (United Kingdom) and in exploration Basic Petroleum International (France).

For a net energy importer country, FDI plays an important role in the importation of fossil fuels and their distribution to end-users. The wholesale import of fossil fuels is dominated by foreign companies while local independent firms operate a majority of Guatemala's service stations (table I.3).

In addition to commercial imports of fossil fuels, bunker oil is also imported for industrial purposes, mostly for power plants. The energy companies importing bunker oil are Duke, PQP and Genor with a 25.0 per cent, 17.7 per cent and 5.3 per cent market share in 2008, respectively. Other major importers are Puma Energy, Esso, Shell and Chevron.

## 6. Agriculture

Historically, agriculture has been the main recipient of FDI. Today, while the production of coffee, sugar and cardamom is mostly in the hands of local investors, FDI continues to play an important role,

### Box I.2. FDI in niche agricultural export markets: ornamental plants

Several ornamental plant growers from the United States of America have invested in Guatemala, taking advantage of the country's multiple dependable microclimates that allow for the cultivation of exotic plants year round. The pioneer foreign company in this niche agricultural market is Goldsmith Seeds of the United States of America, which has been in Guatemala since 1966 and currently operates from three different locations with 1,800 employees. The company's success has attracted other companies and today Guatemala is responsible for roughly 20 per cent of all ornamental plant imports into the United States. One such company is Ecke, which began its operations in 1996.

With a plantation of 12 hectares and 750 employees, Ecke Guatemala grows and exports over two hundred species of flora. Yet, it has specialized and excelled in the production of poinsettia (*Euphorbia pulcherrima* or Christmas star). By 2004, Guatemala became the world's top exporter of poinsettia with a peak production volume of 1.5 million floral arrangements a day; Ecke is estimated to contribute over 80 per cent of world exports. The company earned the accolade of "Exporter of the Year" in 1999.

Other investors from the United States of America include: Ball Flora, in operation since 1988 and exploiting 14 hectares and employing 500 persons; Oro Farms, entered in 1996 and operating 4.5 hectares of greenhouse and 2.5 hectares of outdoor plantations with 300 workers; and S&G Flowers with 4 hectares and 75 employees.

Source: PRONACOM.

mainly in one traditional agro-export: bananas. There are three companies from the United States in banana production and distribution: United Brands (ex-UFCO) under its Chiquita brand, Del Monte, which bought some facilities from United Brands in 1972, and Dole, which acquired a 50 per cent share of Anglo-Irish Fyffes Plc's operations for \$26.3 million in 1996. The three large banana producers have reduced their number of plantations<sup>27</sup> in Guatemala and have increasingly opted for sourcing production from independent

<sup>27</sup> Chiquita's 10-K 2009 annual report to the United States Securities and Exchange Commission (SEC) states that the company owns more than 35'000 acres and leases approximately 20'000 acres in Costa Rica, Panama, Honduras and Guatemala. The Compañía Bananera Guatemalteca Independiente (COBIGUA) is Chiquita's wholly-owned subsidiary in Guatemala. Dole's 10-K 2009 annual report states that it owns plantations in Costa Rica (33,600 acres), Honduras (28,400 acres), and Ecuador (3,900 acres) but sources production from independent local producers in Guatemala and Colombia. Likewise, Del Monte reports it owns no property in Guatemala.

local producers through long-term contract arrangements (see land and social issues). All other investment falls into the “non-traditional” category<sup>28</sup> where FDI has helped develop niche export markets (box I.2).

An important more recent investment in the sector has been the entrance of Monsanto in the cash grain market. The company from the United States bought Marmot S.A. for a reported \$135 million in 2008. Aside from its primary business in the production and supply of cash grains (seeds), Monsanto is developing hybrids of vegetables and fruits that offer greater nutrition and yields in Guatemala under its Seminis programme.

In fisheries, Pescanova of Spain has invested in a 227 hectare intensive shrimp breeding farm. The company expanded its operations in Guatemala after the acquisition of Multiprocesos S.A. for \$10.4 million in 2008.

## 7. Transport infrastructure

Although the Government has developed plans to boost private investment in transport infrastructure, including via a new PPP law, FDI in transportation infrastructure has been limited. The Government of Guatemala has awarded one concession in toll roads and one in railways.

The Mexican engineering and construction company Marhnos received a 25-year concession to operate and maintain a toll road of 22 km between Palín and Escuintla (Highway CA-9) in 1997. Initially, the Government took a \$50 million loan to finance the project and, since then, Marhnos has reinvested into upgrading and extending the road.

A 50-year concession to operate railroad services was given to Pittsburgh-based Railroad Development Corporation (RDC) in 1998. In partnership with Guatemalan investors, Ferrovías Guatemala (FVG) was created to administer 322 km of railway connecting the capital to the Atlantic coast. FVG invested \$10 million in the project and handled an annual average of forty thousand tons of cargo (containers, steel, cement, bananas etc.) before it suspended services in October 2007 after lodging a \$65 million compensation claim against the Government through ICSID. The international arbitration is still in process (chapter II).

Apart from these concessions, there is some FDI in construction relevant to transport infrastructure. The Ministerio de Comunicaciones, Infraestructura y Vivienda (MCIV) contracted Solel Boneh of Israel for six road projects between 1998 and 2005.<sup>29</sup> Meanwhile, Rodio-Swissboring has specialized in bridge and tunnel road construction and Holcim, also of Switzerland, has a 20 per cent stake in the local Cementos Progreso.

## 8. Other sectors

In addition to the sectors discussed above, FDI is present in other economic activities, particularly in services. Promising sectors for FDI are BPO and call centres as well as tourism in light of their growth potential.

The BPO/call centre industry in Guatemala was a local initiative driven by domestic entrepreneurs back in the mid-1990s; the first foreign investors arrived in 1998. Due to its competitive costs, proximity to the United States of America (“nearshore”) and the availability of English speakers (although they are fewer today), Guatemala is fast becoming a preferred outsourcing destination. In addition, this industry also benefits from the maquila incentives (Decree 29-89). At present, there are over 50 large in-house

<sup>28</sup> Traditional agricultural products are those that were widely cultivated and exported by 1945: coffee, cotton, sugarcane, banana and cardamom. All other agricultural products are considered “non-traditional”, including fruits, vegetables and ornamental plants.

<sup>29</sup> These are the construction or rehabilitation of roads: CA-1 Occidente Los Encuentros-Cuatro Caminos (60.85 km, 1998); La Casaca-El Naranjo (80 km, 1999); CA-13 San Luís-Poptun-Flores (105.7 km, 2000); CA-14 Cobán-Chisec-Xuctzul (77.9 km, 2002); La Libertad-San Diego (53 km, 2002); and La Cumbre-Purulha (2005).

operations, half of which serve the international market. Major international BPO firms come from the United States of America (ACS, 24/7 Customer, NCO), Spain (Atento/Telefónica, Digitex), Mexico (RY6 Global), France (Capgemini) and India (Genpact).

Tourism also presents a growth opportunity for FDI, although until now it is one of the worst performers in FDI attraction. After remittances, tourism is the second foreign exchange earner in Guatemala. In 2007, the tourism sector's total receipts were \$1.2 billion, surpassing those of coffee, sugar, cardamom and other exports. The supply of hotel rooms (20'840 rooms) does not meet the growing demand which has increased 4.5 times more than the available lodging capacity in 2003-2007. As such, FDI can drive investment and capitalize on tourism growth. At the moment, however, FDI to the sector has been held back by difficulties in the access to secure land titles and security and safety issues. Most international hotels in Guatemala are franchises managed by locals. An important exception to the norm is Barceló Hotels of Spain which bought Marriott Guatemala City Hotel for a reported \$42 million in 2008.

Guatemala is the first and only country to have yielded the management of its official postal service to FDI. In May of 2004, the Congress approved a 25-year concession to Correo de Guatemala S.A., a company owned by International Postal Services (IPS) of Canada. The private company receives technical assistance from Canada Postal Services and is regulated by the *Dirección General de Correos y Telegráfos* (DGTC), as stipulated by law 12-04 that aims to guarantee universality and quality of service.<sup>30</sup> The concession will be reviewed in 2014.

Finally, there is significant FDI in commerce. Retail giants from the United States of America, Wal-Mart and PriceSmart, are both present in Guatemala and have important investments in Central America; they are ranked as the second and 12th largest TNC in the region<sup>31</sup> with annual turnover of \$2.53 billion and \$0.86 billion respectively in 2007. Other large foreign companies, including specialized retailers of electro-domestic goods like Grupo Monge of Costa Rica and Grupo Elektra from Mexico come mostly from the region.

## C. Impact of FDI

The economy of Guatemala has been profoundly shaped by FDI which has played an important role in the country's development. However, evaluating the recent impact FDI has had on employment, business linkages and transfer of skills is a challenging task. No data on exports, imports, employment, wages or fiscal revenue by foreign investors is available in Guatemala. Also, no study on the impact of FDI was carried out. All this, coupled with the country's deficient FDI data collection, impede a comprehensive impact analysis on the economy as a whole. Most of the assessment in this report is therefore based on interviews and information gathered during UNCTAD's fact-finding mission and indirect or proxy data.

### I. Capital and investment

Despite modest gains in the two decades following the Latin America financial crisis of the 1980s, Guatemala's GFCF remains relatively low compared to the region.<sup>32</sup> As the economy recovered from the 1980s financial crisis, GFCF as a percentage of GDP has steadily increased and levels of capital formation today are above those of the 1970s.

<sup>30</sup> The law requires Correo de Guatemala to maintain at least the same amount of distribution points as the public service had at the time of concession to guarantee its universality. It also requires the company to invest a minimum of 3 per cent of its annual income to maintain the quality of the service. Furthermore, the company must pay 5 per cent of monthly income to the Government as well as \$300'000 annually.

<sup>31</sup> According to business magazine, *Estrategia & Negocios* which ranks the Top 200 companies in Central America.

<sup>32</sup> According to the World Bank, in the 2000-2008 period Guatemala's GFCF as a percentage of GDP averaged 18.9. This is better than El Salvador (16.6), and mostly at par with Panama (18.1) and Costa Rica (19.7), yet much less than Honduras (26.1) and Nicaragua (26.9).



The private sector has historically been the main component of GFCF even during the economy's recession in the 1980s when public capital took on a more important role. Although FDI's contribution to capital formation suffered during the 1990s it has rebounded during this decade and has been a significant source of capital in a country with low levels of capital formation (table I.4).

However, compared to other countries in the region, the contribution of FDI to capital formation in Guatemala is still low (table I.1). Countries with similar saving rates are able to rely on FDI for a significantly larger portion of GFCF. In this respect, Guatemala has not been able to reach its potential in benefiting from FDI as a source of capital.

**Table I.4. Capital formation in Guatemala as a proportion of GDP, 1970-2008**  
(Percentage)

	Gross fixed capital formation as per cent of GDP and public/private components			FDI as per cent of GFCF
	Total GFCF	Public GFCF	Private GFCF	
<b>1970s</b>	16.4	3.8	12.4	8.8
<b>1980s</b>	12.9	4.6	8.3	9.5
<b>1990s</b>	14.9	4	10.9	6.3
<b>2000s</b>	18.9	3.3	15.6	9

Source: World Bank, Banco de Guatemala and UNCTAD.

## 2. Employment and linkages

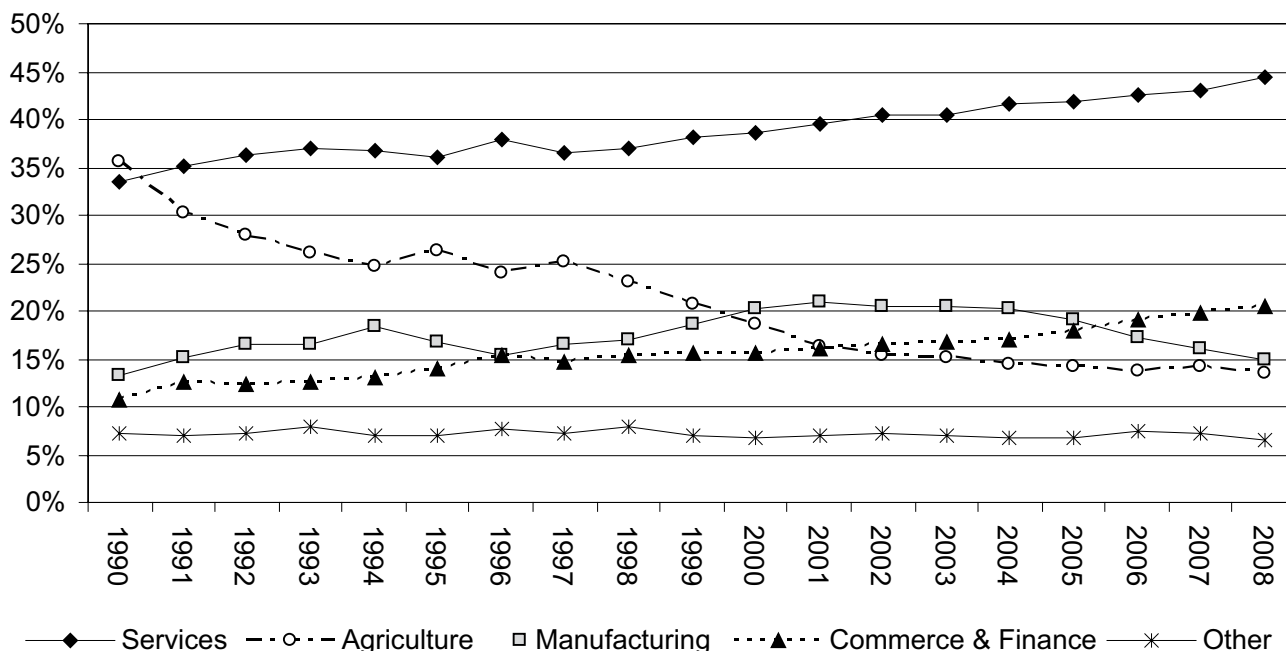
Considering Guatemala's large informal sector and poor availability of official statistics, it is difficult to evaluate the impact FDI has had on employment. In 2008, Guatemala's potential labour force (people of working age) was 9.6 million, of which 4.9 million were "economically occupied",<sup>33</sup> (gross employment rate of 51 per cent). However, 19.2 per cent of the economically occupied population is underemployed as they are unable to work full time. In addition, a 2007 government survey found that there were over 574'000 people employed in the informal sector,<sup>34</sup> although given the nature of this type of economic activity, this number is likely well underestimated (MINTRAB, 2007). There are no official figures estimating the contribution of FDI to employment. Yet, the sectoral composition of employment, as well as individual TNCs' employment data suggest that FDI has contributed to the growth and diversification of formal employment (figure I.3).

The role of agriculture as a source of employment is still significant at 13 per cent but has declined in the past two decades. Apart from direct employment by the TNCs in the banana sector, several foreign companies present in Guatemala act as intermediaries, buying fruit and vegetables from local producers and exporting them mostly to the United States of America and Europe. Although investment from these companies is limited, their steady demand has encouraged local producers to grow alternative cash-crops for niche markets. This has contributed to diversifying the sector and limiting dependence on few traditional agro-exports (e.g. French Bonduelle fostering production of Brussels sprouts). Guatemalan farmers supply companies like Findus (United Kingdom), Ardo NV (Belgium) and several firms from the United States of America such as Contessa and Bestfoods.

<sup>33</sup> According to the *Ministerio de Trabajo y Previsión Social* (MINTRAB) the economically occupied population (*población ocupada*) is all individuals above ten years of age that work at least one hour a week. This includes people that have a job but are absent by circumstantial reasons (e.g. illness, sabbatical, maternity leave, etc.).

<sup>34</sup> The survey found that the main economic activities within the informal sector were the sale of fruits and vegetables (19.5 per cent), butcheries (17.2 per cent) and clothing (14.5 per cent).

**Figure I.3. Employment composition, 1990 - 2008**  
(Percentage)



Source: Instituto Guatemalteco de Seguridad Social (IGSS).

Employment in services<sup>35</sup> (excluding commerce and finance), which surpassed agriculture as the main employing sector in 1991, rose from 33.5 per cent of the working force in 1990 to 44.5 per cent in 2008. FDI in BPO services is a fast growing sub-sector and an important component in job creation within the services sector. It currently employs over 9'000 people and there are several foreign firms operating large call centres (with over 500 workers).<sup>36</sup> Telecommunications is another large employer in the service sector. Teléfonos alone, for instance, has 700 direct and 4'000 indirect employees. The same is true of the electricity sector in generation and distribution. Finally, Correo de Guatemala employs 1'077 people.

Another important sector for job creation has been commerce and finance. The sector's contribution to employment has grown from close to 10 per cent in 1990 to 20 per cent in 2008. Wal-Mart, one of the largest employers in the region, has over 24'000 workers in Central America and 32 per cent of its stores are located in Guatemala. Aside from major foreign retailers, the entrance of foreign banks in the last few years has also contributed to employment.

The share of manufacturing employment has been decreasing since the early 2000s, in parallel with the booming activity in the services sector. In this respect, reaping Guatemala's untapped potential to become a regional hub for manufacturing FDI would contribute to increased employment generation, both directly and through increased supplier linkages (see below).

The impact FDI has had on employment can also be measured in terms of wages. In sectors that require high-skilled workers with specific training and where FDI plays a dominant role, average annual salaries appear to be higher. This seems to explain high salaries in mining and electricity which are dominated by foreign employers with little competition from domestic firms and require high-skilled labour (e.g. engineers).<sup>37</sup>

<sup>35</sup> Statistics for the Services sector include public services.

<sup>36</sup> These include 24/7 Customer (900 workers), Genpact (700), ACS (650), Capgemini (500), Digitex (500).

<sup>37</sup> According to the IGSS, the best paying sectors in 2008 were mining and electricity which paid an average annual salary of Q69,202 and Q62,516, respectively while the national average is Q40,283. Also, the average salaries in these sectors (along with manufacturing) have experienced the highest growth rates in the last couple of years.

### **Box I.3. Obstacles to potential linkages in agro-industry and manufacturing**

Lala Group of Mexico entered Guatemala by acquiring Foremost, a local producer of dairy products in April 2008. It currently employs 450 direct employees and has invested \$2 million in modernizing the facilities and distribution system.

At the moment, Lala imports all products from Mexico, including half a million litres of milk per day, while only Foremost production remains local (50'000 litres/day). Although the company is interested in establishing local suppliers, it is unable to do so because local milk is very expensive at \$1.20 per litre. This is due to the fragmentation of local producers which are mostly small producers operating an entirely manual process. Furthermore, low standards of quality and transportation inefficiencies make sourcing local inputs unfeasible.

The company is looking after government support for farmers and trying to convince local producers to associate in cooperatives and introduce a semi-automation process. If these issues were addressed, Lala would be ready to invest \$15 million to service Central America from Guatemala and expand local production by as much as five times the current output.

For its part, Procter and Gamble currently operates one powder detergent and chlorine production plant in Guatemala. It employs 250 workers and services Guatemala and the rest of Central America exporting 60 per cent of output. At the moment most inputs are imported, only 25 per cent of chlorine and 2 per cent of inputs for detergent production are purchased locally. The firm has encouraged local suppliers to upgrade their facilities to bring salt production to meet the required technical standards. Still, despite the fact that these suppliers would have a guaranteed buyer, no domestic firm is willing to take the risk to invest in an upgrade.

These cases illustrate Guatemala's unexploited potential in creating business linkages between TNCs and local suppliers which are not only beneficial to the SMEs involved, but also to the economy as a whole as they can increase overall productivity through the transfer of technology and know-how.

Source: UNCTAD and company interviews.

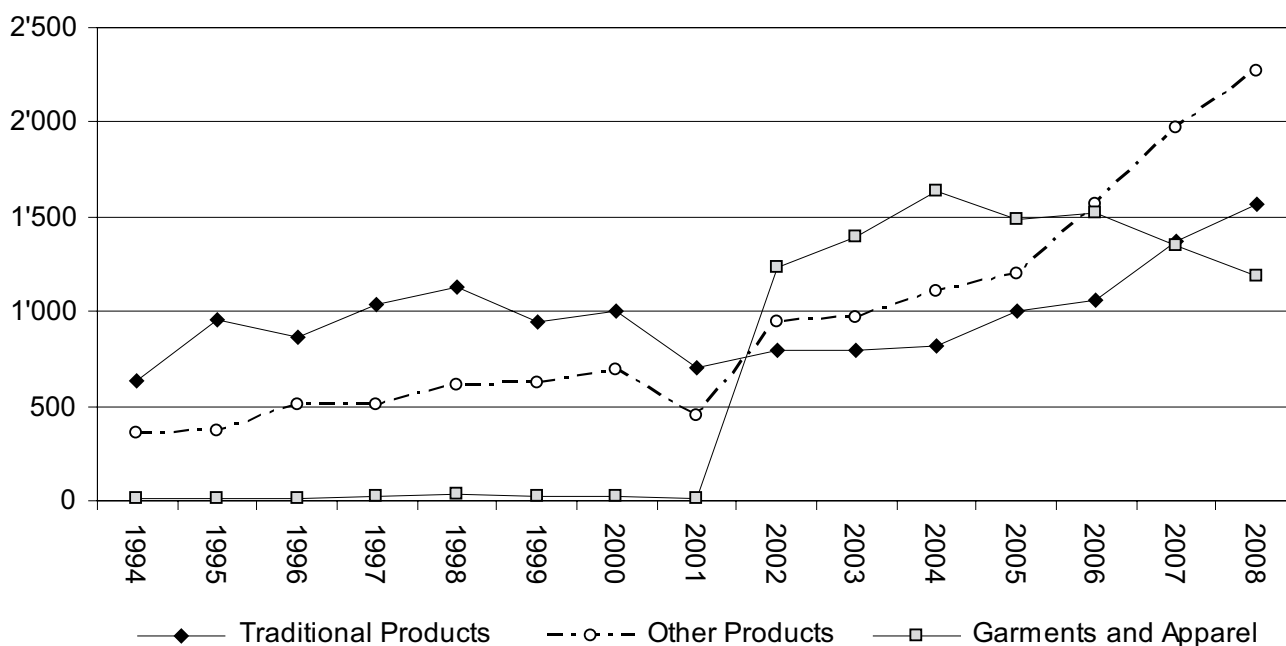
The Government has no official programme to foster business linkages between FDI and local companies. Few examples could be identified by UNCTAD as TNCs present in Guatemala import almost all inputs. Where there is potential for some backward linkages, with domestic firms acting as suppliers, several obstacles impede their realization (box I.3). Thus, the Government of Guatemala should consider creating a national linkages programme to help local firms reach world-class standards and integrate themselves to international supply chains. A successful programme should provide financial support, training and benchmarking (chapter III). UNCTAD is involved in promoting linkages programmes in various developing countries, among others Uganda and Brazil.

### **3. Export diversification**

Guatemala has experienced growth in new export sectors due to FDI. The country has been able to diversify its exports away from traditional agro-exports (coffee, bananas, sugar and cardamom) into other products, including garments and apparel, petroleum, fruits and vegetables, manufactured food products and minerals. All the above-mentioned "non-traditional" industries, which surpassed the export value of traditional goods in 2002, have benefited from FDI. As a result, non-traditional goods (including garments and apparel) grew from representing 24.7 per cent of total exports in 1994 to 44.6 per cent in 2008 (figure I.4).

In this respect, the greatest success story is the textile industry as garments and apparel have become Guatemala's top export since 2002. Textile exports, which were previously negligible, experienced a boom and rose dramatically from \$9.2 million in 2001 to \$1'229 million in 2002; exports peaked in 2004 at \$1'636 million. They have declined slightly since then but still represent 15.3 per cent of total exports, the single largest component. Although there are many domestic players in the industry, firms from the Republic of Korea have invested heavily in textile manufacturing under the maquila regime. Their products target the United States market, a practice that has been reinforced by the ratification of DR-CAFTA. Guatemala's obligation to comply with WTO rules on export subsidies by 2015, however, presents a key challenge to the industry (chapter II).

**Figure I.4. Export diversification, 1994 - 2008**  
(Million dollars)



Source: Banco de Guatemala.

Petroleum has experienced significant export growth driven almost exclusively by FDI. Since Perenco of France began operating the Xan oil field, the value of petroleum exports have more than tripled going from \$100 million in 2001 to \$374 million in 2008, making it Guatemala's fourth export earner.

Manufactured food products have also experienced an important rise in exports and, today, represent 3.9 per cent of total exports, the country's sixth export. As a traditional domestic manufacturing sector, Guatemalan firms have played an important role in this growth as they have established their presence in the region.<sup>38</sup> However, FDI has been instrumental in expanding production capacity in the sector which has been marked by significant investments (Bimbo, Kraft, Del Monte, etc.). Many TNCs interviewed by UNCTAD indicated that Guatemala has a high potential to become an export hub to Central America and southern Mexico.

Fruit and vegetable production are niche markets that have developed in recent years, and represent together 5.6 per cent of total exports. Guatemala's diverse micro-climates are favourable for the cultivation of several fruits and vegetables year round that are exported to North American and European markets. Although production is mostly in the hands of local farmers, FDI has been the catalyst of growth in these

<sup>38</sup> Three Guatemalan food producers, with operations throughout the region, made *Estrategia and Negocios*' list of top 100 companies in Central America: Alimentos Maravilla S.A ranked 66 with a turnover of \$80 million in 2007, Alimentos S.A. came at number 81 with \$47.4 million and Disar at 85 with \$43 million.

non-traditional agro-exports acting as intermediaries and marketing the produce to meet the demands of customers in developed countries. Consequently, these niche markets have important job creation potential considering that a large portion of the population is employed in agriculture.

Prior to 2005, when Goldcorp of Canada began its operations in the Marlin mine, mineral exports from Guatemala were insignificant averaging \$4.2 million in annual income and accounted for less than 0.2 per cent of total exports between 1994 and 2004. Since Goldcorp began operating the Marlin project, production and exports have grown dramatically, placing mining among the top ten exporting sectors in the country. By 2008, mineral exports from Guatemala reached \$270 million, 3.5 per cent of total exports and once the problems that mire the mining industry are solved, this contribution is expected to increase. Mining has the potential to become a significant contributor to fiscal revenue pending the approval of a draft law set out to reform the mining code by increasing royalties and fiscal revenues (chapter II).

#### 4. Transfer of skills and know-how

There seems to be little in the way of skill transfer taking place in Guatemala. There is no methodological approach to assess the contribution FDI has had on developing human capital, although TNCs do train their personnel to meet shortages in technical high-skilled workers (e.g. engineers in mining, electricity and telecommunications). Findings from the mission point to weak transfer of know-how as there are no high-profile cases of companies adopting international managerial practices to enhance the competitiveness of a domestic industry.

Several foreign investors interviewed during the mission complained about the scarcity of skills at the professional and technical levels, and in selected scientific domains such as engineering. This is consistent with Guatemala's low percentage of workers with secondary and tertiary education. For example, the availability of English speakers was sufficient to start up the call centre business in the country yet, as the industry grew, bilingual workers became scarce and this deficit in language skills has become a major obstacle to further expansion. Training their employees does not appear to be a priority for TNCs unless it is inevitable due to a lack of particular skills in the labour market. By law, both domestic and foreign firms must pay 1 per cent of workers' salaries into a government training programme known as Intecap.

Another recurrent issue brought by most foreign investors was the highly restrictive work visa requirements that made the hiring of expatriates very difficult. The low numbers of foreign workers in Guatemala hamper the transfer of managerial know-how.

#### 5. Infrastructure services

Since the privatization of the electricity and telecommunications sectors, FDI has played a key role in the maintenance and expansion of these infrastructure networks. Guatemala's electricity installed capacity grew by 29 per cent in the past seven years going from 1'703 MW in 2001 to 2'197 MW in 2008; roughly 40 per cent of that capacity expansion can be attributed to FDI. Electrification coverage has also improved since the entrance of FDI in distribution going from 66.4 per cent in 1998 to 83.5 per cent in 2008. As such, Guatemala is catching up to the best performers in the region: El Salvador (83.4 per cent), Panama (87.1 per cent), and Costa Rica (98.3 per cent).<sup>39</sup>

Despite these improvements in coverage, Guatemalans keep paying some of the highest prices for electricity. In 2008, average electricity rates to end users peaked at \$0.21 per kilowatt-hour (kWh) and

<sup>39</sup> According to the ECLAC and World Bank *Latin America and Caribbean Electricity Utility Benchmarking*.

since then have come down to \$0.19 per kWh, the least competitive in the region.<sup>40</sup> The cost of electricity in Guatemala is high in part due to the high reliance on fossil fuels as a source of energy. Fossil fuels, representing about 45 per cent of total generation, are sensitive to volatile international prices.<sup>41</sup> Although FDI has not yet brought down electricity prices for end users in the country, diversification in sources of energy and continued competition among distribution companies should reduce the cost of electricity in the future.

In telecommunications services, the number of fixed lines has grown by a factor of 1.8 in the last ten years of FDI presence in the sector, going from half a million in 1998 to 1.4 million lines in 2008. Even more impressive is the growth in mobile lines that went from 0.1 million to 14.9 million during the same time span. This places Guatemala third in Central America in per capita terms with 76 mobile lines per 100 people behind only El Salvador (89.5 per cent) and Panama (90 per cent).<sup>42</sup>

Guatemala has one of the most competitive mobile telecommunication rates in Latin America thanks to the presence of FDI. Competition in mobile telephony has yielded several service plans with rates ranging from \$0.03 to \$0.12 per minute; the current average rate of a mobile call is \$0.06 per minute. As such, Guatemala offers the second lowest cost for telecommunications services in Central America after El Salvador (\$0.04 per minute). In a recent survey, 51.9 per cent of managers from foreign companies considered telecommunications services to be “very good” and ranked them as the country’s strongest competitive asset (AMCHAM, 2009).

Prices in fixed telephony, where Telmex (Telgua) enjoys a quasi-monopoly, have increased. When telecommunications services were public, the cost of fixed line calls was very low and subsidized. Immediately before privatization there was an indexation to increase rates to make the sale of Telgua more attractive. Since then, Telmex continues to raise rates alleging that the prices do not cover costs. Although most consumers have migrated to mobile telephony and thus high rates are not much of an issue, weak competition in fixed lines has become more of a problem for internet costs. Telgua provides DSL through fixed lines while its competitors like Telefónica do so through wireless technology. All three main companies in telecommunications have very good fibre optic cable networks connected to Central America, the United States of America, and the rest of Latin America.

In terms of road infrastructure, the participation of FDI has been minimal as most investment is public. The national railroad system that was out of use and suffered important damages after Hurricane Mitch was partly refurbished and 300 km became operational thanks to FDI. Unfortunately, the rail freight service has now been discontinued pending the result of international arbitration.

## 6. Land and social issues

In the past, FDI has had a negative impact on land distribution. The UFCO used to own immense tracts of arable land and used its dominant position to keep competitors, even small producers, from entering the market. Moreover, due to the risk of harvest loss (e.g. crop disease, natural disasters), the company purposely kept a share of arable land idle and employees, who usually lived in company housing and were entitled to a small plot, could be evicted at any moment. The 1952 Agrarian Reform Law changed this abusive situation by expropriating and redistributing idle land to peasants.<sup>43</sup>

<sup>40</sup> By comparison, the residential price of electricity was \$0.16 per kilowatt-hour in El Salvador (2008), \$0.15 in Panama (2006) and \$0.14 in Nicaragua (2006). Costa Rica and Honduras have even lower rates but they are distorted by Government subsidies: Honduras \$0.09 (2006) and Costa Rica \$0.08 (2006). Statistics for industrial rates in Guatemala are unavailable. Large consumers can freely negotiate long-term power purchase agreements directly with generation companies. Self-generation is also an increasingly popular practice in Guatemala.

<sup>41</sup> The breakdown of fossil fuels used in electricity generation is the following: fuel oil (bunker) 31.3 per cent, coal 13.06 per cent and diesel 0.2 per cent.

<sup>42</sup> 2007 International Telecommunications Union (ITU) statistics.

<sup>43</sup> The Guatemalan Human Rights Commission (GHRC) estimates that 372'000 acres of UFCO land were expropriated and redistributed by February 1954 (roughly 66 per cent of UFCO total property).

Evidence showed that over time, TNCs worldwide have divested from direct production and opted, at first, to source bananas from local independent producers through long-term arrangements. This trend towards contract farming has been replicated to other agricultural products. The disengagement of TNC from production activities reflected the introduction of restrictions to foreign ownership of land, perhaps more importantly, a change of bargaining power in the marketing chain. Effectively, controlling the downstream end of marketing (distribution and commercialization), rather than production, has become an increasingly important aspect for TNCs.

The same trend has been observed in Guatemala, where local land ownership, although concentrated among a few people, has gradually replaced foreign land ownership. The adoption of this practice is partly due to the inequality effect that FDI has had on the distribution of land in the country. Nowadays, social opposition to foreign land ownership continues to manifest itself particularly against large mining and hydroelectric projects. The issues are further discussed in chapter III.

#### D. Overall assessment

Since the end of the Civil War (1996), Guatemala has clearly embraced and committed itself to market-oriented reforms. The Government has taken several steps to stimulate trade and investment in the country, including the adoption of the investment law in 1998, the privatization of state-owned enterprises, the active participation in all regional economic blocks, and the conclusion of FTAs with major trading partners. Furthermore, prudent macroeconomic administration led to one of the smallest sovereign debts in the region, and a consistent improvement in the country's credit ratings. As a result, over the last decade, FDI inflows have experienced a rise unprecedented in Guatemala's history.

Although FDI has entered basically all sectors of the economy, and despite its long standing presence in the country, it is difficult to assess its impact. Data collection on FDI is deficient and there has been no systematic evaluation on its contribution to the economy as a whole on behalf of any government agency. Research and interviews with several actors suggest that FDI has had a positive impact on job creation, particularly on wages, in the sectors in which it is present. Also, FDI has been an important driver behind export diversification as non-traditional exports have decisively surpassed traditional agricultural ones. However, it appears that FDI has offered little transfer of skills and know-how, and business linkages with local enterprises are few and basic. In comparison to other countries in the region, FDI represents a minor source of capital in Guatemala.

The Government has set a goal to attract \$1.5 billion in annual FDI inflows by 2013. To accomplish this, Guatemala will have to sustain an average annual growth rate in FDI inflows of 25 per cent from 2008 onwards. A difficult task considering FDI inflows for 2009 are estimated to have fallen by 25 per cent from the previous year due to the global financial crisis. This setback may jeopardize Guatemala's objective, the attainment of which will rely on a quick global recovery and continued improvement to the investment climate.

Guatemala has the potential to become an important hub for FDI in Central America and regional headquarters to many TNCs considering the country's various advantages. These include, among others, geographical location facilitating trade, market size, competitive labour costs, macroeconomic stability and an excellent telecommunications infrastructure. Realizing such potential, however, requires the adoption of initiatives to address key social challenges (e.g. high crime, low education). This includes enlarging its market size, through a more equitable distribution of income and better provision of education and health services. Furthermore, the continued reform in the legal framework for investment is necessary as some regulatory issues that hinder FDI remain. A detailed examination on legal and regulatory issues is included in chapter II.





## II. THE INVESTMENT FRAMEWORK

Guatemala has been a pioneer in the attraction of FDI (chapter I) and its investment legislation reflects an open and non-discriminatory approach towards the entry and operation of foreign investors across the economy.

Since the 1990s, government policies have aimed at macro-economic stability as well as trade and investment liberalization. A new impetus followed the Peace Agreements of 1996, which led to new reforms meant to further improve the investment climate, including a new investment law, the privatization of several utilities and the liberalization of the foreign exchange market. On the trade side, the liberalization and regional integration process initiated in the 1960s with the Central American Common Market was followed by the Northern Triangle with Mexico in the 1990s. In the current decade, this process culminated with the signature of the CAFTA-DR, new bilateral trade agreements with Colombia and Chile and the Association Agreement with the European Union.

Although these market-oriented reforms have generally introduced modern legislation and policies, they have often not been accompanied by institutional arrangements adequate to ensure appropriate oversight of the market. The absence of a competition law and agency is a case in point. The limited budgetary capacity of successive Governments, constrained by extremely low fiscal revenues, has also contributed to the institutional weakness of many agencies and public institutions. Consequently, the provision of key public services (e.g. security, education and health) and the fulfilment of public mandates (e.g. ensuring environmental protection and efficient justice) have suffered. The institutions in charge of the design and implementation of investment policy, investment promotion and dispute prevention have also been weak.

Against this background, public functions are often delegated to notaries or have become overly burdensome bureaucratic processes. This has made it difficult for Government to effectively administer rules and regulations and for investors to comply with them. Encouragingly, the increased use of information technology has proved very useful in modernizing and streamlining some public services, notably in the areas of tax payments, customs or real estate registration. Yet, as described in this chapter, there is scope for further reforms aimed at creating a better environment for business.

### A. Specific FDI measures

The main legal instrument regulating FDI is the Foreign Investment Law (Decree No. 9 of 1998). Among the stated objectives of the Law are the creation of a regime favourable to the attraction of FDI; the removal of limitations and restrictions applying solely to foreign investors; and the consolidation into a single legal instrument of the main rules and principles that regulate foreign investment, except for those contained in sectoral laws.

Following the Code of Commerce, the locus of incorporation of a company is the only criterion determining its nationality. Hence, any company, independently of whether the capital is partly or wholly foreign-owned, is considered a Guatemalan company provided it is incorporated under Guatemalan law. Those companies follow the same registration process as local companies (see Section B.I below) and their liability is limited to the local assets. Only the foreign capital invested by a shareholder in the company, and not the company itself, is protected by the Foreign Investment Law.

The Foreign Investment Law also applies to foreign investors incorporated under foreign laws operating in Guatemala as *foreign companies*, (which maintain the same corporate structure of their country of origin), or *branches*. Their establishment in the country is subject to additional company registration procedures. Among them are the legalization and translation of all statutory documents, the appointment of a local legal representative and the institution of a guarantee bond in favour of third parties for an amount of at

least \$50'000, which is meant to secure possible liabilities left by the foreign corporation after termination of business operations. Foreign companies and branches also accept parent company liability (unlimited subsidiary liability), which is the reason why most foreign investors opt to register local companies instead (see section B.I).

The Foreign Investment Law is liberal in its approach to the entry of FDI. Nonetheless, the law contains inconsistencies with other domestic laws and with Guatemala's international investment treaties which might be invoked in case of disputes with investors. Moreover, the institutional aspects of the Law relating to the investment promotion and facilitation agencies have not yet been implemented and are not coherent with the actual institutional setting in this area. At the same time, a clear and coordinated direction for the design and implementation of investment policies at the national and international levels is missing. These issues are analyzed in the following sections, together with suggestions for improvement.

## 1. Entry and establishment

Guatemala has one of the most open FDI regimes in the world. The Foreign Investment Law grants foreign investors the right to participate in any economic activity in Guatemala (art. 4). Likewise, no restrictions exist with respect to the acquisition of shares of local companies by foreigners and no limits are set as to the percentage of acquisition and control of investment. The only limitations to the entry of FDI that still persist pertain to the following:

- *Forestry*: Art. 126 of the Constitution reserves the exploitation and renewal of forestry resources to "Guatemalan citizens or companies".
- *Insurance*: foreign companies cannot establish branch offices. This restriction is currently being reviewed by the authorities.
- *Professional services*: Art. 213 of the Commercial Code prohibits foreign companies from providing professional services for which a university degree is required.

Given that the nationality of the investor is only determined by the locus of incorporation, some ambiguity remains as to how these restrictions are implemented when a foreign investor incorporates as a local company.

## 2. Treatment and protection under the Investment Code

The Foreign Investment Law offers good standards of treatment to foreign investors. Some protection provisions of the Law should however be reviewed since they are formulated to offer guarantees that are incompatible with the domestic legislation (such as "indirect expropriation" and "measures equivalent to expropriation").

### a. Treatment

The principle of national treatment of FDI is recognized in the Foreign Investment Law (art. 2 and 3) and no noticeable exceptions are observed in practice. The Law also grants all foreign investors the same treatment, independently of their country of origin (art. 3). Moreover, it prohibits imposing performance requirements on the entry and operation of foreign investors, such as forced technology transfer or employment generation requirements.

## b. Protection

The foreign investment law offers foreign investors, independently of the origin of their capital, absolute rights that are generally granted on the basis of reciprocity, typically in the context of international investment agreements, such as protection against indirect expropriation. This can be problematic because the Law uses concepts of international customary law which are not consistent with the national juridical system. Revision is therefore necessary, including bringing the dispute resolution provisions of the Law in line with modern international standards.

### *Expropriation*

It is important to mention that no expropriations have been carried out in Guatemala since World War II. Both the Constitution (art. 39) and the Foreign Investment Law (art. 5) protect private property and the full rights of the investor over its investment. They both also guarantee the investor against expropriation, which can only take place for duly proven “eminent domain, national interest, or social benefit”. Any expropriation measure needs to comply with the principles of non-discrimination, legality and advance and effective compensation, except when such “advance compensation” is not foreseen in the Constitution (art. 40 of the Constitution and art. 6 of the Foreign Investment Law).

Decree 529 of 1948, the Expropriation Law, further details the conditions for expropriation and the modalities for determining adequate compensation. This includes the value of the expropriated good and all damages resulting from the expropriation, including interests. These provisions are usual features of modern investment legislation.

However, the Foreign Investment Law goes further to protect the investor also against *indirect* expropriation and against any *measure equivalent to expropriation* (art. 6). It therefore introduces inconsistency between the different national legal sources and with the bilateral investment treaties (BITs) signed by Guatemala. This raises issues with respect to legal coherence that could lead to problems for the Government in case of disputes with investors. Any future revision of the investment law should remove reference to “indirect expropriation” and “measures equivalent to expropriation”, therefore ensuring consistency with the Constitution and the expropriation law.

### *Funds transfer*

In line with the liberal attitude towards FDI which characterizes the Foreign Investment Law, foreign investors are granted full funds transfer guarantees (art. 8 of the Foreign Investment Law). They have free access to the foreign exchange market (liberalized in 2001) and to free currency convertibility. In particular, transfer guarantees include:

- Remittance of funds related to the invested capital and the full proceeds of divestment;
- Repatriation of any profits and gains generated in Guatemala;
- Payment and repatriation of dividends;
- Foreign debt and related interest;
- Fees and royalties;
- Payments related to the compensation in the case of expropriation.

### *Dispute settlement*

Guatemala is a signatory to the United Nations Convention on the Recognition and Enforcement of Arbitral Awards (New York Convention), the Inter-American Convention on International Commercial

Arbitration (Panama Convention) and the Convention on the Settlement of Investment Disputes between States and Nationals of other States (ICSID).

Guatemala's Foreign Investment Law also permits international arbitration or alternative resolution of disputes between the State and foreign investors. This is however limited to those investors that are protected by an investment agreement that explicitly allows recourse to arbitration (art. 11), and within the limits of what is prescribed in the agreement. The Law is silent on the guarantees for foreign investors to access domestic tribunals (although this is implicit in the national treatment standard), and on whether access to international arbitration is only possible after the domestic recourse avenues have been explored. In any future revision of the Law, these gaps should be addressed.

Guatemala's Arbitration Law No. 67 of 1995 is applicable in case of disputes among investors, where so agreed by the parties. It is based on the UNCITRAL Model Law for International Commercial Arbitration and its regulations are in line with the New York Convention. The law establishes that foreign arbitral awards are fully enforceable in Guatemala (art. 46 and 47). Alternative dispute resolution mechanisms such as conciliation are also foreseen in the law (art. 49).

In addition, chapter 10 of CAFTA introduces an additional dispute resolution mechanism for investors of its member countries. A first claim under CAFTA for indirect expropriation was filed in June 2007 by a United States company against the Government of Guatemala with ICSID.<sup>44</sup> The case is still pending. A second case before ICSID is based on the BIT between the Governments of Guatemala and Spain. It was filed by the Spanish company Iberdrola Energía S.A. in April 2009 and related to the electricity distribution concession and the rate of value added tariff in distribution of electricity (VAD).<sup>45</sup>

#### Double taxation

Guatemala has not signed any double taxation treaty (DTT) so far, although such treaties are under negotiation with the Governments of Spain and France. Article 10 of the Foreign Investment Law contains some protection provisions with respect to fiscal issues. It prohibits "confiscatory taxation" and double or multiple internal taxation on foreign investment.

### 3. The bilateral and regional investment treaties framework

**Table II.1. Bilateral and regional investment treaties signed by Guatemala**

TREATIES	PARTNER COUNTRIES (dates)					
In force	Chile (13.10.01)	Taiwan Province of China (01.12.01)	Cuba (10.08.02)	Republic of Korea (17.08.02)	The Netherlands (01.09.02)	Argentina (07.12.02)
	Spain (21.05.04)	Czech Republic (29.04.05)	Switzerland (03.05.05)	Sweden (01.07.05)	CACM (06.01.06)	CAFTA-DR (01.03.06)
	Germany (29.10.06)	Finland (06.01.07)	France (28.01.07)	Belgium -Luxemburg (01.09.07)	Italy (15.01.08)	Israel (15.01.09)
In negotiation	Morocco	United Kingdom	Romania	Russian Federation	Thailand	Ukraine
Awaiting signature, ratification or entry into force	Canada	Czech Republic (renegotiation) Signed 20.08.09	Austria Signed 16.01.06	European Partnership Agreement	...	...

Source: UNCTAD and Directorate of Foreign Commercial Policy of Guatemala/CAZM.

<sup>44</sup> The Railroad Development Corporation alleged that the Government of Guatemala indirectly expropriated the company's assets by negating a contract and requested \$65 million in compensation and damages.

<sup>45</sup> The CNEE set a reduced tariff of \$7.22 kw/h, down from \$8.22 kw/h, in August 2008. Iberdrola claimed that the reduction in the tariff affecting its earnings was illegal. The company filed a case against the Government of Guatemala for \$672 million for what it regards as indirect nationalization. ICSID accepted the case on 17 April 2009 and the decision is pending (ICSID case no. ARB/09/5).

Guatemala has a relatively large network of investment treaties covering the main countries of its incoming FDI. As of late 2009, it had concluded investment treaties with 19 countries in Latin America, Europe and Asia (table II.1). The majority of BITs were signed and ratified after 2000. The Central American Common Market (CACM) and CAFTA-DR also contain very comprehensive investment chapters which cover the standard range of guarantees usually contained in BITs.

Generally, BITs in force in Guatemala have a similar format and contain internationally accepted treatment and protection standards. Their specific content is however often different, highlighting a lack of consistency among the agreements as well as the absence of a structured model for negotiations.

A review of Guatemala's BITs was recently carried out by UNCTAD and the Organization of American States in the context of a technical assistance programme in the area of investment legislation, international investment agreements and dispute resolution mechanisms. The review highlighted the following:

- The BITs differ with respect to the definition of investment and the identification of the nationality of the investor. Some refer to the place of incorporation, others to the principal place of business;
- All BITs guarantee "fair and equitable treatment" of foreign investors, but they differ with respect to the adopted standard;
- All BITs protect investors in case of expropriation, although the language utilized across the treaties is not coherent;
- All BITs guarantee the free transfer of funds, but they do not foresee any temporary exception in case of balance of payment difficulties;
- All BITs contain a simple and general mechanism for the resolution of investor-State disputes;
- Most BITs contain a general protection clause allowing investors to claim rights and benefits from the provisions of other signed treaties.

On the basis of the analysis of Guatemala's BITs, UNCTAD elaborated together with the Government of Guatemala a model BIT for future negotiations and recommended the Government to conduct a case-by-case assessment of the need to revise the signed BITs in order to correct and improve those provisions that might be the object of potential disputes.

#### 4. Institutional setting

A chapter of the Foreign Investment Law (chapter IV) and the implementation decree of the Law (Decree No. 893-88) are devoted to the functions of an agency called "Single Window for Investments". Based on the law, the agency, which is placed under the responsibility of the Ministry of Economy, is charged with promoting and facilitating investment. It is also mandated to coordinate the promotional activities of all other government agencies; oversee the simplification of administrative requirements for investment; execute agreements resulting from the country's policy in the area of investment; set up a statistical collection system to evaluate FDI trends and impact; and perform a number of other functions typical of a modern investment promotion agency.

The Single Window for Investments has however long been dismantled. Instead, in the context of the policy to promote FDI, the Government set up a Presidential Commissioner on Investment and Competitiveness, made up of two executing agencies: the National Competitiveness Plan ("PRONACOM") and a new agency called "Invest in Guatemala".

PRONACOM was created by a Government Agreement (No. 306 of 2004), while Invest in Guatemala, which has been in operation since 2006, was legally created in 2008 (Government Agreement No. 20).

PRONACOM has set the competitiveness agenda for Guatemala, acting as a public-private interface aimed at promoting the reforms needed to increase Guatemala's competitiveness and attractiveness vis-à-vis foreign investors.

Invest in Guatemala, according to its constituent instrument, is meant to perform general advisory functions such as proposing, fostering and developing actions and procedures aimed at improving investment promotion in the country. In practice, however, the role of Invest in Guatemala is to support foreign investors in their scoping for business opportunities in the country. In this respect, the agency has assumed over time several functions of a typical investment promotion agency, including investor targeting, facilitation and advocacy. The staffing and the functions of the agency have varied over time due to difficulties in securing stable financial support and reliance on *ad hoc* funding from international partners. At the time of UNCTAD's fact-finding mission, the agency was undergoing further restructuring, led by an international assistance programme with the Inter-American Development Bank (IADB).

The institutional framework described above raises two key issues: 1) the discrepancy between the Foreign Investment Law, the Government Agreements and the practice should be addressed not only to reduce legal uncertainty, but also to provide the national investment promotion agency with the adequate legal mandate to effectively perform its role; 2) very important functions that had been assigned by the Foreign Investment Law to the Single Window for Investment back in 1998 have not yet been implemented.

This is the case, for instance, of the statistical collection system that the Window would have established to evaluate FDI trends and impact. Chapter I has highlighted the shortcomings related to FDI data collection in Guatemala. These undermine the capacity to assess the FDI attraction performance of the country and leave policymakers with little information on the impact of FDI inflows on employment, exports, fiscal revenue and other indicators. Such information would be very useful to guide policy decisions in the area of FDI.

Likewise, the coordination function that the law assigned to the Window with respect to promotional activities of various government entities with an investment promotion mandate is not among the functions of Invest in Guatemala. Although the agency has gone a long way in fostering informal cooperation channels, these are not institutionalized and have negative implications on the coherence and efficiency of the national investment promotion effort. It is therefore strongly recommended that any future reform of the investment legislation rectifies the mismatch between the law and current practice.

Thus, the authorities should introduce new legal and institutional arrangements for investment promotion that are consistent with practice and also with the official policy objectives in this area. In this regard, the Government should redefine the name, mandate and functions of the investment promotion agency as they appear in the investment law. Chapter III of this report analyzes the role and functions of this agency in greater details.

The Government should also create appropriate coordination mechanisms among the Central Bank, the investment promotion agency and the statistical office for the collection of accurate FDI statistics and address the need to ensure their availability by legally requiring all companies to comply with annual investors' surveys; UNCTAD has an established programme of technical assistance in this area and stands ready to assist the Government in setting up such mechanisms.

Similarly, institutionalized coordination mechanisms to design and implement Guatemala's investment policy at the international and national level are missing. The lack of coherence in the negotiation of investment treaties discussed above is a case in point. It is also reflected in the adoption of *ad hoc* solutions when the country is faced with investor-State disputes. For instance, in order to coordinate the Government's response to the cases before ICSID, a temporary *ad hoc* "Interinstitutional Commission to Support the

Arbitration Process” was created in May 2009 (Government Agreement No. 128 of 2009). The Commission, which is only meant to operate for two years or until these cases are solved, is composed of representatives from the Ministry of Economy, the Ministry of Foreign Affairs, the Ministry of Energy and Mining, the Office of the Attorney General and the General Secretariat of the Presidency.

In this respect, UNCTAD’s recent diagnostic of the key issues faced by Guatemala in the area of investment recommended that the Government create an improved mechanism aimed at preventing disputes between foreign investors and the State and adequately responding to them if they occur. To this end, it is recommended that a Coordinating Agency be established, as well as a permanent Interinstitutional Support Committee. They would:

1. Create a dispute prevention mechanism;
2. Create an alert mechanism;
3. Coordinate amicable negotiations and other alternative dispute resolution mechanisms; and
4. Coordinate the defence of the State.

## B. General measures

### I. Company establishment

Investors evaluate the ease to start a business as an important factor when they choose an investment location. Several studies have established that there is a direct relationship between administrative efficiency, growth and employment (UNCTAD, 2010).

The Commercial Code regulates the specific legal form that companies can take in Guatemala. The most common type of company is the limited liability company (“Sociedad Anónima”). Existing rules are generally applied without discrimination as to nationality of the shareholders. However, foreign banks, private financial companies, insurance companies and companies in the forestry sector must establish as local corporations.<sup>46</sup> Foreign banks may also operate in Guatemala through the establishment of a branch or the registry of representative office.

All investors (domestic and foreign) must publish their intent to conduct business and register with the Ministry of Economy (at the Commercial Registry) and the Tax Administration Supervisory Authority (Superintendencia de Administración Tributaria –SAT), as part of the company registration process detailed in the following sections. Foreign investors willing to register a foreign company or a branch in Guatemala instead of incorporating locally, as per the definition of the Code of Commerce described in section A.I, are however subject to additional preliminary requirements. They need to:

1. Grant a power of attorney to a Guatemalan lawyer and register it at the General Registry of Protocols and at the Commercial Registry;
2. Legalize and translate into Spanish a number of documents including: a) power of attorney; b) articles of incorporation of the parent company and all modifications; c) resolution adopting the decision to register in Guatemala; d) certified copy of the last balance sheet together with the profit and loss statement; and e) declaration of the legal representative of the company;<sup>47</sup>
3. Deposit into a local bank the capital to operate in the country;

<sup>46</sup> CAFTA-DR commitment to change this limitation in 2010, draft legislation is ready for discussion at Congress.

<sup>47</sup> Indicating that: i) the company guarantees the execution of its acts and contracts with all its properties and assets in Guatemala and abroad; ii) the company will submit to the jurisdiction of the courts and laws of Guatemala; iii) neither the company, its representatives nor its employees will invoke their status as aliens; and iv) the company will comply with legal requirements before leaving the country.

4. Establish a guarantee or bond in favour of third parties for an amount of no less than the equivalent in Quetzales of \$50'000. The bond must remain valid for the duration of the company's operations in Guatemala. The exact amount of the guarantee shall be determined by the Commercial Registry based on, among other factors, the amount of the investment;

These requirements are not used specifically to screen or discriminate against foreign companies although they do represent a disincentive to invest and their efficiency needs rethinking. For instance, the legalization of foreign documents follows long and costly procedures involving home country authorities, the Guatemalan consulate abroad, the Ministry of Foreign Affairs in Guatemala and a local public notary. The entire process could be simplified by ratifying the Hague Apostille Convention abolishing the requirement of legalization for foreign public documents (box II.1). Commercial Registry statistics show that only 219 foreign companies were registered between 1999 and 2009, less than 0.01 per cent of annual registrations. Most foreign companies established instead as local companies with foreign capital. The guarantee requested from foreign companies has been seldom used, and is often avoided by creating a local company with foreign capital, which also has the advantage of limiting parent company liability.

### Box II.1. The Hague Apostille Convention

The Hague Convention of 1961 abolishing the requirement of legalization for foreign public documents ("Apostille" Convention) is administered by The Hague Conference on Private International Law (HCCH). This Convention facilitates the international circulation of public documents between its 97 States party. The legalization formalities are reduced to the simple delivery of a certificate in a prescribed form, entitled "Apostille", by the authorities of the State where the document originates. This single certificate eliminates the complexities of the chain of legalizations preserving the maxim *acta probant sese ipsa*.

The use of modern technologies in the implementation of this Convention is encouraged. To this end, an electronic apostille pilot programme (e-APP) has been developed to promote and assist the implementation of low-cost, operational and secure software technology for the issuance/use of electronic apostille (e-Apostilles) and the creation/operation of electronic registers of apostilles (e-Registers).

Source: Hague Conference on Private International Law.

Apart from the additional registration steps mentioned above, all companies, foreign and local ones starting a business in Guatemala require mandatory registration with the Commercial Registry and the tax authority.<sup>48</sup> According to the UNCTAD e-regulations programme, which analyzes and compares company establishment procedures across developing countries, these two registrations alone require 35 steps, against the 9 steps necessary in Colombia<sup>49</sup> and 14 in El Salvador (table II.2). Opening a company takes on average 29 days,<sup>50</sup> though some investors reported that the procedures can take up to three months and Guatemala scores among the lowest ranked countries in the world in respect of the "starting a business" indicator of the World Bank Doing Business (World Bank, 2010).<sup>51</sup> Nonetheless, companies can usually start operations before waiting for the final registration, based on a provisional registration which is delivered within 72 hours.

<sup>48</sup> When a company has more than three employees, it also needs to register at "Instituto Guatemalteco de Seguridad Social" (IGSS) and the Ministry of Labour.

<sup>49</sup> In Colombia notaries have been eliminated from small and medium size company creation procedures.

<sup>50</sup> <http://www.doingbusiness.org/ExploreEconomies/?economyid=81#StartingBusiness>.

<sup>51</sup> Guatemala shifted from position 147 out of 183 in 2009 to 156 in 2010 in the World Bank Doing Business, indicator: starting a business.



**Table II.2. Company registration in Guatemala, Colombia and El Salvador, 2009**

<i>Guatemala</i>	<i>Colombia</i>	<i>El Salvador</i>
<b>Total Steps : 35</b>	<b>Total Steps : 9</b>	<b>Total Steps: 14</b>
1. Searching for name availability (optional)	1. Carrying out prior checks	1. Checking the availability of a name
2. Obtaining a letter for opening a bank account	2. Drawing up the incorporation document and filling out forms	2. Issuing a check and/or valuation of assets
3. Opening a bank account (local company)	3. Requesting turn at Commercial Registry	3. Requesting public deed of incorporation and notary certifications
4. Obtaining articles of incorporation: local company	4. Paying forms and registration fees	4. Collecting the public deed of incorporation
5. Purchasing forms for procedures at the "Registro Mercantil"	5. Calling to check registration status	5. Certifying initial balance sheet
6. Purchasing tax stamps (local company)	6. Requesting to wait for a turn (Certificate of existence)	6. Paying of commercial registration rights
7. Certifying signature in the form for commercial registration	7. Collecting the certificate of existence, buying and registering the commercial books	7. Requesting commercial registration and deposit balance sheet
8. Ordering payment for registration of company, edict and publication	8. Requesting turn to deposit commercial books	8. Collecting commercial registrations
9. Paying of registration of the company, for the edicts and its publication	9. Collecting the commercial books	9. Requesting tax forms
10. Requesting provisional registration		10. Paying tax registration
11. Publishing edict in "Diario de Centroamérica"		11. Requesting tax registrations (NIT and NRC)
12. Ordering payment to obtain certification of provisional registration		12. Requesting legalization of accounting books and authorization of the accounting system
13. Paying certification of provisional registration		13. Collecting accounting books and accounting system
14. Requesting certification of provisional registration		14. Issuing and registering shares
15. Collecting certification of provisional registration		
16. Legalizing signature on the business registration form		
17. Ordering payment for the registration of a business		
18. Paying registration of a business		
19. Obtaining the business license		
20. Obtaining definitive registration and company license		
21. Purchasing and obtaining forms for formalities at "SAT"		
22. Registering at "SAT" (local and foreign companies)		
23. Obtaining form for registration of shares		
24. Issuing and printing of shares		
25. Legalizing signature on share form		
26. Ordering payment order for issuance of shares		
27. Paying share issuance		
28. Notifying share issuance		
29. Collecting the share issuance notice		
30. Ordering payment for authorization of accounting and corporate book at "SAT"		
31. Paying authorization of accounting and corporate books at "SAT"		
32. Authorizing of "SAT" accounting and corporate books		

Guatemala	Colombia	El Salvador
33. Ordering payment for authorization of accounting and corporate books at the "Registro Mercantil"		
34. Paying for authorization of accounting and corporate books at the "Registro Mercantil"		
35. Authorizing accounting and corporate books at the "Registro Mercantil"		

Source: UNCTAD, e-Regulations database.

The procedure to start a business described in table II.2 is based on two *ex ante* control mechanisms. The first takes place when the Commercial Registry reviews the public deed of incorporation before handing the provisional registration to the new company. In 2009, the Registry reported that 60 per cent of the requests did not pass this control.<sup>52</sup> This high rejection rate is symptomatic of the difficulty for the user to produce the required documentation and calls for a simplification. In El Salvador, for instance, pre-established models of company statutes are provided to facilitate the procedure.

The second *ex ante* control is carried out by third parties, who can object to the registration of the company in the eight days following the publication of the new company in the official Gazette. In 2009, the Registry reported that only 1.4 per cent<sup>53</sup> of the requests were subjected to opposition. This means that almost 99 per cent of the companies had their registration unnecessarily delayed by this procedure. In a more efficient system, *ex post* controls should be introduced and companies should be registered before publication, while third parties would retain the power to object in the eight days following the publication of the final registration.

Changing from an *ex ante* to an *ex post* third party control mechanism would safeguard transparency of registrations (instead of requests) without imposing unnecessary delays. It would also result in the elimination of one extra step, i.e. the presentation of the publication record necessary to request final registration. Some developing countries have let go of some transparency for increased efficiency by eliminating the publication requirement. Moving to an online publication could be a better option that would not jeopardize transparency, while improving efficiency.

Moreover, too often the procedures require the investor to resort to a public notary, even though no specific public function is involved to justify their involvement. For instance, investors need to produce a notary letter to open a bank account for the company and each request form to the commercial registry needs to be notarized, making the procedure more burdensome and expensive than necessary. Various duplications in the registration process can also be eliminated, for instance: a) Guatemala is the only country in Central America which requires the authorization of accounting books by both the tax administration and the commercial registry; b) at least six different fees involved in the registration procedure and the payment of each of them requires an order of payment; c) fiscal stamps are to be paid on each licence and notary authentications.

The Government has recognized the need to simplify the procedures and has implemented several initiatives to improve efficiency without compromising its duty to safeguard the public interest and provide accurate information. However, so far, these initiatives have either been partially implemented, reversed or abandoned. The Commercial Register, for instance, has become a one-stop shop where the key institutions involved in the registration of companies (except for the Ministry of Labour) are represented to facilitate the procedures.<sup>54</sup> They need, however, to improve communications and coordinate forms and data requirements to reap the benefits of a one-stop shop approach.

<sup>52</sup> In 2009, the Commercial Registry received 51 12 requests for company registration, 31 29 of those requests were rejected and had to be presented again. The total number of registered companies was 4474.

<sup>53</sup> In 2009, the Commercial Registry recorded 72 oppositions to registration of companies.

<sup>54</sup> At the Registro Mercantil, there are representatives from SAT, IGSS, "Tipografía Nacional" (official newspaper where the request for registration has to be published) and a bank agency to receive all the necessary payments.

In 2006, a single-window service (“*ventanilla ágil*”) was introduced and allowed companies to request all registrations with one form. This initiative was a good step forward and gained Guatemala the World Bank’s “top reformer” status in 2007. However, the service has been discontinued as it did not, according to representatives of the Commercial Registry, comply with the law. Furthermore, public notaries did not know about this service and had continued using the longer procedure.<sup>55</sup>

On the basis of the analysis done for this report, a full review of the commercial registration process should be undertaken as a priority. It would identify the necessary regulatory reforms and propose a process based on few and simple steps, making full use of modern IT services following the example of the modernization of SAT and the General Registry of Property (see land section). Specific recommendations to achieve the necessary simplification include to:

1. Eliminate the bank practice of requesting a notary to deliver a letter to open a bank account for the new company.
2. Streamline the registration procedure and remove unnecessary steps and duplications. A single registration form should be re-introduced and based on the automatic electronic circulation of the request between the entities involved in the process;
3. Make the registration procedure available online, to facilitate access for the entire country;
4. Eliminate the need to notarize documents required for registration and the practice of requesting a notary to deliver a letter to the bank to open a bank account for the new company.<sup>56</sup> Forms could be signed under oath, eliminating the cost of legalization and facilitating the implementation of an electronic process. The integrity of the company registration request will be guaranteed by the public deed where the articles of incorporation are kept;
5. Consolidate all fees and taxes in one single payment and remove the fiscal stamps, which are a legacy of the medieval times no longer used in most countries;
6. Improve communication between commercial registry and the public: make all the steps of the registration procedure clearly available; implement a simple user guide and provide models of the documents that need to be presented for registration; an online tracking system is already available, it may be complemented by a notification service (SMS and e-mails are used in other countries);
7. Second a representative of the Ministry of Labour to the Commercial Registry;
8. Deliver company registration before publication, replacing *ex ante* with *ex post* opposition mechanisms;
9. Adopt the company license or “*patente de sociedad*”, received upon completion of the commercial registration, as the only company identification document.

In addition, it is recommended to simplify the procedures to legalize foreign documents by ratifying and implementing The Hague Apostille Convention.

#### *Other issues in the Commercial Legislation*

Corporate governance rules should be improved to encourage investor confidence, improve transparency of corporate decisions and their monitoring. The law requires the use of generally accepted accounting principles (GAAP). However, the Guatemalan Institute of Auditors and Public Accountants adopted the use of International Financial Reporting Standards (IFRS). The law should thus be updated to reflect this substantive change of standard.

<sup>55</sup> According to information gathered at the Commercial Registry in Guatemala City, in 2008 only five companies were register following the “*ventanilla ágil*” procedure.

<sup>56</sup> The predominant participation of notaries in administrative procedures should be revisited. Other countries in region, such as Colombia, have eliminated the requirement to have the statutes of the company authorized by a public notary.

The absence of a developed stock market makes investment opportunities scarce and takeovers difficult. Like in the rest of Central America, the capital market is underdeveloped. Most companies are small and many are family businesses. Nonetheless, a very liberal platform for the development of an equity market was introduced in 1996.<sup>57</sup> The law was recently modified to allow the registration and negotiation of securities in foreign currency issued in Guatemala or abroad.

For transparency purposes, all stakeholders in the market (agents, stock exchanges, etc.) and public offers are required to register at the “Registro del Mercado de Valores y Mercancías”. This public institution facilitates information among market participants and issues fines when legal requirements are not met; it does not, however, conduct financial or prudential analysis.

The National Stock Exchange (BVNSA)<sup>58</sup> has modern infrastructure in place, including electronic trading and centralized custody system. However, this market is very thin with only few registered shares and very few transactions. Operations, which have been increasing in spite of the global financial crisis, are mainly short-term, focusing on corporate debt market and government bonds. Implementing an efficient capital market is one of the future challenges in Guatemala (further explained in chapter III). To this end, it will be essential to address the issue of infrastructure development. Corporate laws lack incentives to develop a local equity market. In this respect, this report recommends adopting the existing proposal to revise the law to include a new type of mixed company to implement public-private partnerships. Another type of company that could be introduced is the variable capital company.

In conclusion, a revision of the Commercial Code is recommended to expand on the available types of legal entities, improve corporate governance and support the development of the stock market.

## 2. Foreign exchange arrangements

Guatemala has fully liberalized its foreign exchange regime. A floating exchange rate regime, free of restrictions on payments and transfers for current and capital transactions, is in place.<sup>59</sup> The exchange rate policy allows for central bank interventions under neutrality and flexibility<sup>60</sup> criteria to reflect market tendencies. The exchange rate flexibility has helped cushion the impact of the crisis; in particular, the depreciation helped mitigate the impact of the decline in remittances on demand and contributed to reverse a mild overvaluation of the Quetzal (IMF, 2010).

Furthermore, the law on free negotiation of foreign currencies<sup>61</sup> allows the use of any foreign currency in domestic transactions. For example, financial institutions can accept deposits and make loans in foreign currency; most of these transactions are done in United States dollars or in Euro.

## 3. Taxation

The Peace Agreements of 1996 included explicit fiscal policy objectives,<sup>62</sup> such as raising fiscal revenue to a minimum of 12 per cent of GDP. This was meant to provide the State with the resources needed to fulfil its goals and address the pending development issues in areas such as education, healthcare, security and infrastructure. A national consultation process to implement these objectives resulted in a 2000 agreement known as the “Fiscal Pact”. This pact set the direction for fiscal policy, including proposals for fiscal modernization, recommendations to improve the quality and transparency of public spending and actions to improve tax collection.

<sup>57</sup> “Ley de Mercado de Valores y Mercancías”, No. 34-1996.

<sup>58</sup> In what appears peculiar for a country of the size of Guatemala, several stock exchanges are registered to function in the country. The “Bolsa de Valores Nacional” (BVNSA) is the biggest one.

<sup>59</sup> Guatemala has accepted obligations of IMF Article VIII, sections 2, 3, and 4.

<sup>60</sup> Programa Nacional de Emergencia y Recuperación Económica. Gobierno de Guatemala, enero 2009.

<sup>61</sup> Decree 94-2000 Ley de Libre Negociación de Divisas.

<sup>62</sup> See the “Agreement on social economic aspects and agricultural situation”, paragraph 47.

To date, the Fiscal Pact has only been partially implemented and progress towards increasing fiscal revenue, fighting tax evasion and enhancing the transparency of government spending has been modest. According to the United Nations Economic Commission for Latin America and the Caribbean (ECLAC), Guatemala has one of the lowest tax yields in Latin America (Cabrera, 2009). Tax revenue for 2009 was estimated at 10.35 per cent of GDP, falling short of the target set in the Fiscal Pact.

Among the structural factors that contribute to the low fiscal revenue and high tax evasion are the structure of the corporate tax, which leaves a large scope for tax engineering, impunity from tax evasion and a weak fiscal culture. In addition, the financial crisis and ensuing post-recession in the period 2008-2009 help explain the reduced tax revenue.

This section reviews the key elements of the fiscal regime affecting business. A specific treatment of the fiscal regime for the mining sector is presented in chapter III of this report.

The principal taxes for business in Guatemala are the corporate income tax, which applies either on gross income or net profits, a tax on the value of net assets and a land and real estate tax. The value added tax (VAT) applies and stamp duties are used on several documents. No capital duty and environmental tax are in place.

### **Corporate tax**

Income tax is based on the territoriality principle, whereby resident and non-resident companies are subject to income tax but it is applied only on their Guatemalan-sourced income. This is defined as any income arising from capital, goods, services or rights invested or used in Guatemala, or originating from activities performed in the country.

Companies and individual entrepreneurs may choose between the following regimes:

- a. General tax regime: companies are subject to a flat tax of 5 per cent on their gross income, regardless of profit margin or income levels.
- b. Optional tax regime: this is a standard corporate income tax, with a rate of 31 per cent on net taxable income. This is the highest corporate tax rate in Central America.

Net taxable income under the optional regime is defined as gross income minus necessary costs and expenses to generate such income or to preserve the revenue source. Deductible expenses are standard items available in most tax codes, however, costs and expenses are deductible only up to 97 per cent of total income. Only in the first year of company operations may tax losses be carried forward and then only for one year. No other loss-carry forward (or back) is allowed. This is unusual and implies that genuine loss-making companies will be required to pay taxes.

Depreciation is allowed for a standard range of fixed assets and is generally on a straight line basis. Intangibles can also be amortized over a period of at least 5 years. The annual depreciation rates for the major groups are as follows:

- Immovable property (such as buildings) at 5 per cent;
- Furniture and equipment at 20 per cent;
- Vehicles and machinery at 20 per cent;
- Computers (including software), at 33.33 per cent;
- Tools at 25 per cent.

Companies are not allowed to programme depreciation of fixed assets over time (for example by deferring deductions from one year to the other) in order to ensure that asset depreciation has a genuine effect on the income tax base.

The fiscal year is the calendar year. Tax payments are made every quarter under the optional regime, and monthly under the general regime. Tax filing and payment are efficient, thanks to a process of modernization of the SAT and the introduction of electronic payments in 2001.

The implementation of the general income tax regime has been an important simplification measure, which is frequently adopted across Latin America and elsewhere to the benefit of small enterprises.<sup>63</sup> In Guatemala, however the IMF estimated that, in 2007, 64 per cent of the taxpayers classified as big and medium chose this regime. In particular, service companies, like telephone companies, with profit margins exceeding 16 per cent had chosen the gross income regime costing millions in terms of lost tax revenues. One of the primary considerations behind the introduction of the 5 per cent regime was to limit the abuse of deductions under the former regime (a standard 31 per cent corporate income tax), due to inadequate secondary legislation, supervision and sanctioning mechanisms.

Nonetheless, the current system leaves room for many avoidance practices. For instance, taxpayers under the gross income regime can opt to change to the net income regime once a year and they tend to change to the optional regime (31 per cent on net income) when their profit margin decreases. Also, in the absence of transfer pricing regulations, the system favours tax engineering and fiscal evasion. It was reported to the UNCTAD team that many investors open shell companies so as to be able to make use of both regimes to pay less taxes.<sup>64</sup>

**Solidarity tax (or ISO).** A tax on net assets is also levied on a quarterly basis on companies that carry out commercial and agricultural activities and that derive a gross profit margin of more than 4 per cent of their income. The tax rate is 1 per cent, and it applies on the greater amount between 25 per cent of the value of net assets and 25 per cent of the gross income. Taxpayers whose net assets are four times greater than their gross income pay the tax on their gross income.

The objective of the tax is to ensure the payment of a minimum tax when the taxpayer chooses the optional tax regime. ISO payments may be credited to the income tax to avoid double taxation. Companies in the “maquilas” and free zone incentive schemes (box II.2) are exempt from the ISO for the duration of their exemption from the income tax and so are education institutions, enterprises in their first year of operation, taxpayers with losses in two consecutive years and taxpayers who have chosen to use the general regime of income tax.

### **Capital gains and withholding taxes**

Depending on the corporate tax regime applied, capital gains are either subject to tax at the rate of 10 per cent (general tax regime) or 31 per cent (optional tax regime). Loss-carry forward of 5 years is available against capital loss under the optional regime.

Dividends paid out of taxed profits to non-residents are not subject to withholding taxes but to a 3 per cent fiscal stamp tax. Dividends paid from non-taxed profits are subject to a final withholding income tax at the rate of 10 per cent on the gross amount.

Interest paid to non-residents is also subject to a 10 per cent withholding tax. Interest on foreign loans granted by financial institutions is tax-exempt, provided that the foreign currency has been sold within the local bank system. Royalties paid to non-residents are taxed at 31 per cent on the gross amount.

<sup>63</sup> Many countries in Latin America have adopted a turnover-based taxation that applies only to SMEs. These include Plurinational State of Bolivia, Brazil, Costa Rica, Chile, Mexico, Nicaragua, Perú, and the Dominican Republic.

<sup>64</sup> For instance, by opening two companies, one in manufacturing, subject to the optional regime, and one in services, subject to the general regime and transferring expenses to the former and profits to the latter.

No double taxation treaties (DTTs) are in place, although negotiations in this regard are underway with France and Spain, as mentioned earlier.

### ***Indirect taxes and others***

Indirect taxes represent the main source of fiscal income for the Government. In 2009, value-added tax (VAT) collection alone represented 50.2 per cent of the taxes levied in the country.<sup>65</sup>

**Value-added tax (VAT).** VAT is levied at a single rate of 12 per cent on domestic goods and services, sales, rents and imports of goods. The export of goods is zero rated. VAT exemptions apply to certain institutions such as non-profit organizations or educational institutions; several operations including financial services and retail sales on foodstuff in local markets up to GTQ 100 (around \$12); certain transfers of property (like mergers or creation of companies and purchases of real estate for a value of up to \$17'500) and generics, alternative medicines and medicines against HIV.

VAT payers have to file a monthly declaration. Excess VAT payment is refundable. VAT refunds are very slow, even though some progress has been achieved over the last four years. Three reimbursement schemes exist. Under the general one, which applies to companies that export less than 50 per cent of their output, VAT reimbursement can take up to seven months. Companies that export more than 50 per cent of output fall under the second regime and receive a refund in about three months. A recently introduced "optional" regime reduces the refund time to two months but as of end of 2009, it was reported that only about 70 companies qualified.

**Customs and excise duties.** Customs duties follow the Central American Agreement on Tariffs and Customs Regime. They are applied on c.i.f. (cost, insurance, freight) value at 5, 10, 15 or 20 per cent rates. Excise duties are applied to certain products and services, which range from tobacco and beverages to cement, petroleum product distribution and tourism.

**Stamp duties and special notary paper.** Certain documents or contracts are subject to a 3 per cent stamp duty. Special notary paper, which is used in contracts authorized by notaries, pays GTQ 1 per page. The Government is considering raising the notary paper tax to GTQ 10 per page.

**Circulation of vehicles.** It is an annual tax on all types of transport vehicles with rates of 1 per cent for new vehicles and lower as the vehicle ages.

**Land and Real Estate Tax (Impuesto Único sobre Inmuebles – IUSI):**<sup>66</sup> It is an annual *ad valorem* tax on real property in urban and rural areas. The collection and administration of IUSI has been decentralized to those local Governments (municipalities) that have the adequate means to handle it. In 2007, more than 70 per cent of local Governments were in charge of the administration of this tax (233 out of 332). However, according to MINFIN statistics, the collection of this tax has dropped since its decentralization and continues to be concentrated in urban areas.

The value of properties is estimated through a self-evaluation by the owners ("autoevaluación"). The tax is levied on owners or holders of immovable property on a progressive basis at the rates shown in table II.3.

<sup>65</sup> <http://portal.sat.gob.gt/sitio/estadisticas/Prueba/COMP%20TOTAL%202007.htm>. This percent is calculated under the gross income tax.

<sup>66</sup> Decree 15-98

**Table II.3. Immovable property tax in Guatemala - rates in GTQ and destination**

Real estate value	GTQ 0 – 2'000	GTQ 2'001- 20'000	GTQ 20'001- 70'000	GTQ 70'001- more
<b>Tax rate</b>	exempt	0.2 per cent	0.6 per cent	0.9 per cent
<b>Revenue destination</b>	-	Municipality	25 per cent, central Government 75 per cent, municipality	

Source: Ministry of Finance of Guatemala (MINFIN).

### **Tax incentives**

The main incentive schemes are aimed at supporting exporting activities, though their application often goes beyond the strictly export-related sectors. The key such incentives are presented in box II.2.

According to the official statistics of the Ministry of Economy, as of 8 October 2009, 704 companies were benefiting from the maquila regime. Out of these, 197 were foreign-owned and 49 had mixed capital. The Ministry also reported that over the period 2007-2008, the companies that accessed the maquila regime generated around 37'000 jobs. However, based on the analysis of the list of companies under the regime, a recent study has highlighted that only about 16 per cent of them are truly maquila companies, while the others are largely oriented towards the domestic market. The list includes mining, bottling, tobacco and food processing companies and, among them, are many of the largest local and foreign investors of the country (Gutierrez, 2007).

It was also reported during the UNCTAD fact-finding mission that it is common practice for companies under the maquila regime to change name every 10 years to be able to continue benefiting from the associated fiscal incentives. This creates a situation of unfair competition between companies which are in and those that are out of the maquila regime and is another factor behind the high levels of fiscal evasion. The SAT estimates that the foregone fiscal revenue related to the maquila regime totalled more than GTQ 989.3 million in 2009 (\$121.4 million), corresponding to about ½ a point of GDP (SAT, 2010). When considering all tax exemptions deriving from the Constitution and other laws, the percentage would rise to 8 per cent of GDP.

The export-related incentives of the free zones and maquila laws are incompatible with the WTO Agreement on Subsidies and Countervailing Measures as they are directly linked to export performance. WTO members have to remove incompatible incentives by 2015. At the time of the UNCTAD mission, in November 2009, no serious discussion had yet been initiated within Government and with the business community on how to address this issue. The time has thus come to re-evaluate the effectiveness of the existing incentive schemes and discuss their abolition or replacement by more effective and less distortive ones.

Guatemala's fiscal regime is certainly attractive to investors. However, it fails to produce sufficient revenue to provide essential public services and address the economic and social needs of the majority of the population. This situation, already recognized in the late 1990s by the fathers of the new democratic order within the Peace Agreements, underlies the Fiscal Pact, whose objectives are far from achieved. To date, only a small minority of individuals and companies pay taxes.<sup>67</sup> The corporate income tax regime as it stands favours tax engineering, arbitrage and evasion; it discourages start-ups and leads to abuse of the available incentive schemes by companies which are not the target of the incentives.

In light of the analysis presented above, the review leads to several main recommendations on re-orienting tax policy to better serve Guatemalan development and investment objectives. The reforms

<sup>67</sup> For example, according with the Ministry of Finance 75 per cent of the solidarity tax is paid by 2.3 per cent of the taxpayers, represented in 987 big tax payers: mainly supermarkets, agro-exporters and banks.



### Box II.2. Main fiscal incentives in Guatemala

Guatemala's fiscal incentives for investment largely target the promotion of exports. Incentives also exist for the development of renewable energy. A tourism promotion law, which contained several fiscal incentives, was repealed in 1997. A new law has been under discussion since 2005 but not yet adopted.

#### Free trade zone regime

According to Guatemala's Free Zone Act (Law 65 of 1989), companies that produce goods for export or re-export, companies that commercialize goods to export and re-export them without transforming or modifying the original product and companies that offer services related to international trade can settle in a Free Zone and benefit from the following incentives:

- 12-year exemption from corporate income tax;
- Exemption from VAT for transactions within or between free zones;
- Exemption from stamp duties on the transfer of immovable property located in free zones when the enterprise is also located there;
- Exemption from taxes, duties and charges applicable to the imports to a zone of machinery, equipment, tools, raw materials and in general, all inputs used in the production of goods and granting of services.

Temporary exports from a Duty Free Zones to Central American territory and vice versa are allowed when their purpose is to adjust, transform or repair the merchandise. This is limited to a period of no longer than six months. Free zones' occupants can sell up to 20 per cent of their production in Guatemala.

#### Export activities ("maquila regime")

Incentives are also available for activities that involve the import of primary goods to be processed for exports from Guatemala (Law 29 of 1989), excluding coffee and other traditional exports, such as bananas, sugar and unprocessed cotton. The key incentives include:

- 10-year exemption from the corporate income tax for income derived from the export of goods processed or assembled in Guatemala;
- Exemption from taxes, VAT and import duties on imports of machinery, equipment, components and accessories necessary for production;
- Exemption from export duties;
- A one-year deferral of taxes, VAT, and import duties levied on imports of raw materials, semi-processed products, intermediate products and materials necessary for the export of Guatemalan products. This can be extended for one more year.

#### Renewable energy development

As per Law 53 of 2003, companies that develop energy projects with renewable energy sources benefit from:

- Exemption from taxes, VAT and import duties on imports of machinery, equipment, components and accessories necessary for energy production during a construction period not exceeding 10 years;
- 10-year exemption from the corporate income tax.

Source: UNCTAD.

proposed below should be considered an integral package meant to restructure corporate income taxation to increase fiscal revenue while maintaining fiscal competitiveness. As such, they are not meant to be selectively introduced to the current regime. The recommendations are to:

- Turn the current "optional regime" into the standard corporate tax regime but introduce accelerated depreciation to facilitate company formation and development and progressively reduce its rate to 25 per cent, in line with the regional average, not to discourage local and foreign investment;
- Strengthen the supervisory and sanctioning power of the fiscal authorities vis-à-vis violations of the fiscal legislation;
- Reform the current "general regime" and limit its scope of application by sector, e.g. excluding sectors such as services or extractive industries which should be subject to the standard regime; or by company size, i.e. introducing a turnover limit so as to benefit SMEs, which is typically the primary objective of simplified taxation regimes.
- Reduce the option to change the chosen corporate tax regime to once every five years.
- Introduce rules to regulate transfer-pricing in accordance with international standards.

Other recommendations are to:

- Consider introducing a new VAT rate to increase revenue, while continuing to shelter the poorer segments of the population. Essential goods and services could continue to be exempted from VAT or to be taxed below the current 12 per cent (or VAT exemption regime), while non-essential or luxury goods and services, or those generating a negative externality, could be taxed at a rate of around 20 per cent.<sup>68</sup>
- Negotiate and ratify DTTs with the main existing or potential source countries of FDI in order to avoid double taxation of profits.
- Review the effectiveness of the incentive schemes against the objectives they were meant to achieve and address the WTO compliance challenge as a matter of priority and urgency. Abrupt and last-minute changes should be avoided in order to give time to companies that currently enjoy non-compliant incentives to adjust and contain possible disinvestments. A transparent process of consultations with investors should be put in place to inform this review.

#### 4. Labour

The labour regime in Guatemala is rather liberal. The Labour Code<sup>69</sup> regulates labour rights and employment relationships and the Ministry of Labour and Social Prevention is the entity in charge of labour policy. Labour justice is slow and some instances of labour representation and implementation of international labour conventions are still problematic. The Government is working with the International Labour Organization (ILO) to address these issues.

Employment contracts can be written or verbal (with the latter prevailing in practice), for an indefinite or a fixed period of time or to conclude specific tasks. All individual contracts are considered indefinite unless otherwise specified.

<sup>68</sup> Many OECD countries that apply the value-added tax use differentiated rates according to the nature of the good or service. Some countries in Latin America apply a supplementary sales tax on luxury items. Selected base VAT rates in Latin America are: 21 per cent in Argentina; 19 per cent in Chile; 16 per cent in Colombia; 13 per cent in El Salvador; 15 per cent in Mexico; and 19 per cent in Peru.

<sup>69</sup> Decree 1441 of 1961.

The procedures for hiring and firing set out in the Labour Code are straightforward and in line with the regional standards.<sup>70</sup> Both parties can terminate employment without any liability within the first two months, which are considered a trial period. Thereafter, employment may be terminated by either party with or without just cause. Dismissal for just cause is regulated by the Labour Code and does not generate liabilities for the employer (other than vacations and the 13th and 14th salaries). The burden of proof falls on the employer, and when the Labour Tribunals determine that no just cause existed, the employer is obliged to pay full severance payment and damages for up to twelve months of salary plus judicial expenses.<sup>71</sup>

In case of termination of contract without just cause, the employer pays one month of salary per worked year as severance pay.<sup>72</sup> The same amount is paid to the employee who terminates the employment relation for just cause. No compensation exists in case the employee terminates the employment relation without just cause. Termination of employment due to redundancy situations, including bankruptcy or death of employer, is legally authorized. In such situations the employees' severance payment may be reduced in accordance with the conditions set in Article 85 of the Labour Code.

Employees have to give their employers notice for the termination of their contract according with timeframe given in table II.4. Employers, however, do not have the legal obligation of notifying termination unless they have agreed to do so in the employment contract. This asymmetry should be corrected.

**Table II.4. Notice time for termination of contract**

Employee seniority	Prior notice
First 2 months	None
First 6 months	1 week
6 months to 1 year	10 days
1 to 5 years	2 weeks
More than 5 years	1 month

Source: Article 83 Labour Code.

Employers are required to provide their employees with social security, a Christmas salary and an extra July salary (for a total of 14 monthly salaries a year), 15 days of paid vacation and an incentive bonus of GTQ250 (equivalent to approximately \$30) per month.<sup>73</sup> Social security includes an employer contribution of 10.67 per cent of the employees' wages to the Guatemalan Social Security Institute (IGSS), plus a payroll levy of 1 per cent for the Technical Training and Productivity Institute (INTECAP), which entitles companies to make use of the training services of the institute and another 1 per cent for Private Workers Recreational Institute (IRTRA) (box II.3).<sup>74</sup> The total social security contributions represent around 13 per cent of employee's wages, which is lower than the contribution rate of competitors in CAFTA-DR.<sup>75</sup>

There is a minimum wage that varies according to the type of business activity (table II.5). These rates are revised periodically by the National Commission of Salaries, which is the technical and consultative organ of the Ministry of Labour composed of representatives of the government, employers and employees. On the basis of the recommendations of the Commission of Salaries, the President of the Republic sets the minimum wage. This was reported by investors as cumbersome and consultations to change this system are underway.

<sup>70</sup> Guatemala's "Rigidity of employment index" from the World Bank's Doing Business Report places it at par with the Latin America and Caribbean Region and the OECD Average.

<sup>71</sup> Article 78 of the Labour Code.

<sup>72</sup> Article 82 of the Labour Code.

<sup>73</sup> Decree 37-2001. This incentive bonus is a commitment of the Political Agreement for the financing of Peace, Development and Democracy in Guatemala and it is not included in the severance payment.

<sup>74</sup> Accord I, 118 of IGSS Board of Directors: workers pay an additional 4.83 per cent IGSS contribution while the State should add another contribution, which usually is paid through the provision of real estate properties.

<sup>75</sup> The rate is 26 per cent in Costa Rica, 15.25 per cent in El Salvador, 15 per cent in Nicaragua, 14.19 per cent in the Dominican Republic and 7 to 8.5 per cent in Honduras (IBFD, 2010).

### **Box II.3. INTECAP and IRTRA - innovative services to entrepreneurs and employees**

INTECAP is an autonomous non-profit organization created under Decree 17-72 with the objective of promoting collaboration between the public and private sector to increase the country's productivity and develop its human resources. It provides different levels of technical and technological assistance to all sectors of the economy. The vocational training of workers and persons who want to enter the labour market is done through two types of education services: courses to develop qualifications and courses to improve capacities. Activities and infrastructure are funded through a payroll levy of 1 per cent, government contributions, donations, loans and service fees.

INTECAP has 34 training centres in different regions of the country and 30 mobile units to access remote areas.<sup>76</sup> It offers a wide range of training courses for industry, commerce, handicrafts, agriculture and services. In 1999, it started a process of modernization through the acquisition of the ISO 9001:2000 certification; the implementation of a labour evaluation and certification system; the execution of new training strategies, such as e-learning, mobile units, and parallel training in enterprises and INTECAP centres; it also invested in high-tech equipment for training centres and construction of new infrastructure for training on information technologies and communication, banking and insurance, apparel and textiles, meat technology, etc.

INTECAP trains an average of 200'000 Guatemalans annually and feedback is very positive. Both local companies and foreign affiliates use INTECAP training services, either by sending their workers to the available courses or to customized training activities which can be organized upon request to fulfil the company's specific needs. All companies interviewed in this review indicated satisfaction with INTECAP services. Given the limited number of public technical institutes available in Guatemala, the Ministry of Education reported that in 2009, it started financing INTECAP to train around 15'000 students in technical disciplines. Those students are then allowed to access the country's universities.

In 1960, a group of entrepreneurs presented to the Government the idea of creating an institution dedicated to the positive recreation of workers and their families. In 1962 this idea materialized and the IRTRA was created as an autonomous public entity financed with employers' payroll levies. This levy was voluntarily raised in 1992 through Decree 43-92 to 1 per cent of employees' salaries and is paid together with the other social security contributions.

The IRTRA has one hotel complex with almost 700 rooms and five amusement parks in different parts of the country with an estimated capacity for 36'000 persons. The most recent parks, Xocomil<sup>77</sup> and Xetulul<sup>78</sup>, have been awarded several international prizes for their excellent infrastructure, management and innovation. A new park, Xejuyup, is under construction. In its 47 years of existence IRTRA has been distinguished by its excellent service and has hosted close to 47 million people accomplishing its objective of healthy recreation for workers and their families. IRTRA is also open to foreigners and has become an important tourist destination in the region.

IRTRA and INTECAP are good examples of innovative recreation and training mechanisms which have proved effective and efficient in achieving their mandates without undue burden on the public or private sector budgets.

Source: INTECAP, IRTRA and UNCTAD interviews.

<sup>76</sup> The mobile units were created with the financial support of the European Union in the aftermath of the devastation hurricane Mitch in 1998. They have been very successful and have won international awards, like a special mention in the 2009 World Summit Awards under the category of e-inclusion.

<sup>77</sup> Xocomil is a water park was awarded the "best park in the world" prize in 1998 by the world wide association of water parks, and in 2008 was appointed park of the year by the Amusement Today Journal ([www.amusementtoday.com](http://www.amusementtoday.com)).

<sup>78</sup> Xetulul was awarded the Applause Award in 2008, the most prestigious award within the amusement and theme park business <http://www.liseberg.com/en/home/Footer/Press-Releases/The-Applause-Award-2008/>

**Table II.5. Daily and monthly minimum wage rates**

Activity	Rate per Day (\$)	Rate per Month (\$)
Agriculture	7	210
Non agriculture	7	210
Export and “maquila” industry	6.46	194.06
Incentive bonus	1.04	31.25

Source: Agreement of the President of the Republic 347 of 2009.

Notes: Applied exchange rate GTQ1.00x8 = \$1.00.

The general labour law applies over the whole territory, including in the export processing zones, with the only difference that the minimum wage is lower (table II.6). Although rights to unionize are identical, a low ratio of union membership and low incidence of collective bargaining<sup>79</sup> in companies under the “maquila” regime is reported given the excessive requirements in the law to exercise these rights.

As described in Section 7 of this chapter, the judicial system is slow. Labour tribunals are saturated with cases, which can remain pending for many years. Though the number of cases solved through conciliation has increased, the ILO reports a need to strengthen the mediation and conciliation channels provide specialized training on negotiation and dispute settlement, and coordinate with developments related to the new Judicial Organism Mediation centres (ILO, 2009).

However, the rate of unionization is very low (around 8 per cent) and stringent requirements undermine the exercise of union rights. For instance, a trade union can only be established upon agreement by the absolute majority of workers in a certain industry. Also, a strike is possible only with the support of the majority of workers (and not simply of the majority of those casting votes).<sup>80</sup> These issues are aggravated by the serious allegations of grave incidents of violence and assassination of trade union leaders and unionists.<sup>81</sup> In 2008 the ILO Committee of Experts on the Application of Conventions and Recommendations (CEARC) highlighted these and other issues of conformity between the national legislation and the ILO Conventions. The Government of Guatemala indicated in response that the problem of violence does not only affect people involved in trade union activities, but society at large, and that it is taking actions to allocate greater resources to the Special Office for Offences against Journalists and Trade Unionists.

Also, a technical assistance programme of the ILO has helped Guatemala improve the protection of labour rights, and strengthen its labour institutions since 2005. The programme was informed by a “White Book” published by the Ministries of Labour and the Ministries of Trade of Central America and Dominican Republic (MINTRAB, 2005). The key recommendations of the White Book are summarized in table II.6. The ILO is in charge of conducting implementation evaluations every six months.

The Government should continue to address issues of labour protection and trade union rights in cooperation with the social partners and the ILO. Not only would this improve the protection of workers in the country, but it would also positively affect the country’s FDI attraction strategy. TNCs are being increasingly held accountable for the standards of protection that they offer to their workers and the legal frameworks within which they operate. As a consequence, they are increasingly receptive to requests for more socially responsible behaviour.

<sup>79</sup> “Out of 200 “maquilas” only three have trade unions and there only two collective agreements in force. Unions have to compete with solidarity associations set up by employers as a more compliant alternative to trade unions”, International trade union confederation (ITUC) 2009. However, the Government reported to the ILO CEARC that there are ten trade unions in the export processing zones with a total membership of 258 workers.

<sup>80</sup> <http://www.ilo.org/ilolex/english/newcountryframeE.htm>.

<sup>81</sup> The International Trade Union Confederation (ITUC), reported nine murders of trade unionist in 2008 in the Report for the WTO General Council Review of the Trade Policies of Guatemala. Geneva, February 2009.

**Table II.6. Key recommendations of the ILO White Book and their implementation status**

Area	Issues	Recommendations for further implementation
<b>Ministry of Labour and Social Prevention (MLSP)</b>	Strengthen the institutions	Reform sanctions procedures; improve inspection and conciliation procedures; implement the Ministerial Decision 128-2009 which contains “Good Practices, Verification and Investigation in Inspection”; increase the MLSP budget; and strengthen special units for female and adolescent workers.
<b>Labour Courts</b>	Guarantee effective administration of labour justice	Use existing procedures for reinstatement and processing appeals in order to speed judicial proceeding on labour matters; seek legislative solution to ensure that the remedy of “amparo” is not used as a delaying mechanism in proceedings; encourage more training at all levels; publicize the role of the Judicial Organism Alternative Dispute Resolution Unit; improve information systems.
<b>Gender and discrimination</b>	Reform the laws	Continue support to approve draft bill for the reform of the Labour Code relating to gender and discrimination <sup>82</sup> ; expand training and awareness-raising programmes; document and expand good practices.
<b>Worst forms of child labour</b>	Policies to promote the rights of the child, with the goal of establishing a child-labour-free zone consistent with ILO Convention 182	Amend Fireworks Industry Regulations to remove children from the industry; consolidate the operation of the National Commission for the Elimination of Child Labour; implement intra-ministerial protocol for the care of underage workers and approve inter-institutional protocol for the care of underage workers.
<b>Promotion of a culture of compliance</b>	Develop awareness in society of labour rights	Define a strategy to publicize labour rights that includes awareness-raising, dissemination and training; encourage social dialogue in the existing tripartite mechanisms.
<b>General political commitment</b>	Implement the White Paper Recommendations	Reactivate the National Follow-Up Committee

Source: ILO Verification Report on the implementation of the White Book Recommendations.

## 5. Labour skills, employment and residence of non-citizens

Guatemala has a large, unskilled and inexpensive labour force concentrated in rural areas. The workforce has attracted some efficiency seeking investment in the industrial sector (mainly “maquila”) and has promoted the use of labour-intensive production methods in agriculture and construction. In urban areas, higher education levels have fostered the development of the tertiary sector in areas such as call centres and financial services. The relevant skills are nonetheless becoming scarce. For instance, the availability of English speakers, originally an asset for the development of call centres, risks becoming an obstacle for the sector’s growth in the future.

Government spending in education remains well below the Latin American average (3.1 per cent of GDP in the former against 4.1 per cent in the latter in 2007) and the share of the workforce with secondary and tertiary education is one the lowest in the region.<sup>83</sup> Though local managers are well regarded, they are also scarce. The education system is focused in social sciences even though demand is stronger in scientific and technical fields.<sup>84</sup> This is reflected in the dissatisfaction of both local and foreign investors with the quality of the skills of the workforce at the professional, vocational and technical levels. It is also an obstacle for a country wishing to develop more sophisticated industries and services.

The problem is complemented by the relatively restrictive and highly bureaucratic legal framework applicable to the entry of expatriate workers, which further discourages the attraction and retention of skills to the Guatemalan economy. Foreign investors frequently complain, with some justice, about the

<sup>82</sup> To implement actions to prohibit the practice of requesting pregnancy test in the workplace, address difficulties enforcing labour law in agricultural sector; and disputes between indigenous peoples and employers.

<sup>83</sup> World Bank data shows that only 12.4 per cent and 6.2 per cent of the workforce receive secondary and tertiary education, respectively, compared to El Salvador (15.1 per cent secondary and 23.8 per cent tertiary), the Dominican Republic (18.6 and 10.3), Costa Rica (23.9 and 16.8) and Panama (30.0 and 24.0).

<sup>84</sup> UNESCO data shows for 2007 shows that only 3 per cent of students graduate in Science and 14 per cent in engineering and related disciplines (UNESCO, Global Education Database, 2009).

cumbersome requirements, cost and difficulties to obtain work and residence permits for their specialized employees.

According to the Constitution,<sup>85</sup> Guatemalan workers should be preferred over equally qualified foreign workers and the Labour Code stipulates that Guatemalan nationals must account for 90 per cent of the workforce and 85 per cent of the wages.<sup>86</sup> As for managers, the legislation prescribes that foreigners can only occupy up to two management positions and no distinction is made with respect to the invested amount or the strategic nature of the investment. It was reported, however, that the migration regime applicable to management positions is implemented in a more liberal manner.

The Law on Migration recognizes the following categories of immigrants:

1. **Non-residents.** Includes all visitors, tourists and transit entrants. Depending on their country of origin, an entry visa may be required.
2. **Residents.** These are foreigners who are authorized to stay in the country for extended periods of time to conduct licit activities. There are two types of residence permits:
  - a. Temporary: extended to foreigners (investors or employees) for two years (renewable); and
  - b. Permanent: extended to foreign investors, pensioners, or self-sufficient foreigners living on remittances from abroad (“rentistas” in Spanish),<sup>87</sup> the family members of all the above, foreign relatives of Guatemalan citizens, and distinguished personalities. These permits are issued for five years (renewable).

According to the law, in order to receive remuneration, work or carry out commercial activities, including scoping for investment opportunities in Guatemala, foreigners should enter with a business visa,<sup>88</sup> which is issued for 180 days, and is renewable once. If the business person wants to stay after renewal, it is necessary to apply for temporary or permanent residence. In practice, however, many prospective investors enter the country with a visitors’ visa (unless they are citizens from category “A” countries, in which case no visa is needed).

The documentation that accompanies a request for temporary residence is relatively standard, and includes the need to produce evidence of the economic solvency of a Guatemalan sponsor (individual or entity) that guarantees for the applicant. For investors, this guarantee must be complemented by a minimum investment of \$50’000. According to the Migration Law, investors can also replace their temporary residence permit with a permanent one, or opt directly for a permanent residency. However, the regulation fails to describe the conditions and procedures required for the investor to obtain the permanent residence permit, effectively precluding access to this type of permits.

Investors with a residence permit do not require a separate work permit. However, an employer (domestic or foreign) willing to hire foreign employees or managers needs to apply for a work permit for each of them at the Ministry of Labour and Social Prevention (Government Agreement 528-2003 of the President of the Republic). The application must be accompanied by a long list of documents. Some requirements are unnecessarily burdensome and restrictive. For instance, the list includes an employer’s declaration taking responsibility for the conduct of the foreign worker, legalized by a notary; a declaration on the number of national and foreign workers in the company, as well as their respective last salaries, duly certified by an accountant; a declaration legalized by a notary that the foreign worker understands, speaks, reads and writes in Spanish language. Moreover, any error in the filing of the documentation must be amended within 5 days, else the application is rejected.

<sup>85</sup> Article 102 n) Constitution

<sup>86</sup> Article 13 Labour Code, indicates that these ratios may be modified under exceptional circumstances.

<sup>87</sup> Article 30 Law of Migration: pension or self sufficient foreign residents are eligible to the following taxation exemptions: a) duties and VAT on the importation of their household items; b) income tax on foreign source income; c) duties for the importation of a vehicle; d) payment of emigration rights.

<sup>88</sup> Article 85 of the Law of Migration, and Article 77 of the regulation of the Law of Migration.

Complete applications are subject to a resident labour market test, whereby if suitably qualified Guatemalan workers can be found, the application is rejected. For this purpose the MLSP set up a database of human, technical and professional resources. The database is small and only records officially registered unemployed. On average, 1'200 work permits are granted to foreigners every year. The work permit is only valid for one year and may be renewed as many times as necessary, by repeating the procedure described above.

In conclusion, in addition to increasing the quality and availability of domestic skills by boosting government spending on education, the authorities should review the regime applicable to the entry of foreign workers so that it would contribute more actively to the attraction and dissemination of skills that are in shortage. To this end, the following changes to the labour and migration regimes are recommended:

- Revise the permanent residence provisions in line with a full-fledged business talent scheme to attract talented business people. Such schemes focus on the business experience of applicants, rather than the amounts to be invested, but typically set minimum investment thresholds. In this regard, the current threshold of \$50'000 could be increased to \$100'000 to ensure the bona fide of the investment, but would entitle investors and their families to permanent residence and work permit. Adequate monitoring mechanisms to ensure that the investment has taken place within a set period of time should also be introduced.
- Replace the current labour market testing and the cumbersome permitting procedure, which is not effective in protecting local employees, with an active skills attraction programme based on a "scarce skills list", in line with good international practice. This list, prepared by the Ministry of Labour on the basis of a periodic survey of the business community, would determine the categories of foreign workers who should be easily granted residence and work permits and those that should not be allowed entry altogether, based on the scarcity or abundance of the relevant skills in Guatemala. Workers on the scarce skills list should be granted temporary working and residence permits of at least three years or the total duration of the employee's contract, if shorter.
- Implement a skills dissemination scheme, whereby companies hiring foreign workers increase their contribution to INTECAP from the payroll levy from 1 to 2 per cent per foreign worker.
- Devise skills exchange programmes in consultation with industry to provide the market with the skills which are in demand, such as foreign language exchange programmes for language teachers. In view of the future association agreement with the European Union, demand on training in other Latin-languages may also be foreseen, for example Italian and Portuguese.

## 6. Land

Land is one of the key factors of production and access to secure land title is among the key regulatory issues affecting both foreign and domestic investment. In Guatemala, an increasing demand for land is causing several problems. These include land invasions and squatting in rural areas, boundary disputes among neighbours, testamentary disputes, possession without title, multiple land titles and inaccurate measurements.

The Peace Accords recognized these and other land related problems and made the promotion of a secure, simple and accessible juridical framework governing land ownership a key objective. Since then, major reforms aimed at improving the measurement, titling and registration of land have started (box II.4). However, much of the country's territory still needs to be covered by this modernization process. For foreign and domestic investors alike, this translates into difficulties in the access to secure land titles outside of the main cities.



No unusual legal restrictions exist on the access to land title by foreigners. They may use, lease or own real state property in urban and rural areas, except for properties located within 15 kilometres of the borders<sup>89</sup> and in the department of Petén.<sup>90</sup> Access by foreigners to State-owned land requires an authorization from the “Oficina de Control de Áreas de Reserva del Estado”.<sup>91</sup>

The problem of title security is the result of historical, cultural and regulatory factors. In pre-colonial times, indigenous lands were communally owned and rights were recognized through customary rules. In the 16th century, the colonial power claimed property of all the land and distributed it in large homesteads (“encomiendas”) among the colonists, who cultivated them with indigenous slave labour. Slavery was later replaced by a feudal system of indentured servitude, where small plots (“minifundios”) were given to workers in exchange for their services. Large estates (“latifundios”) remained in the hands of descendants of colonial lords. However, most title registries from the colonial times deteriorated or went lost. This historically unequal distribution of land was one of the causes underlying the violent civil conflict. The conflict itself, by displacing a large number of people, further exacerbated the titling issue.

The Peace Agreements of 1996 fostered reforms aimed at improving both the physical measurement of available lands (through the creation of the Cadastre), and the titling of plots. Since then, the introduction of modern geo-referencing technology in the Cadastre and the modernization and digitalization of the General Registry of Property (Spanish acronym RGP) have improved the legitimacy and security of registered land rights (box II.4). Problems concern primarily the large amount of unregistered rights.

Guatemala has a mixed registration system, where registration with the RGP is declarative and not constitutive of rights. Only registered rights are valid before tribunals and vis-à-vis third parties. All land transactions have to be certified by a public notary, as a pre-condition for registering the new rights with the RGP. However, the registration with RGP itself is neither compulsory nor supported by sanctions. Moreover, notaries do not have to send notice of the transaction to the RGP. They only have an obligation to send notice<sup>92</sup> to the tax authorities at: a) the Ministry of Finance Directorate of Cadastre and Appraisal of Real Estate (Spanish acronym DICABI) to update the tax registration of the buyer; and b) the municipality where the property is located, to update registration of the real estate.<sup>93</sup>

The lack of mandatory registration at RGP has originated a problem of multiplicity of titles on the same property. In non-cadastre zones property boundaries are often imprecise. Discrepancies on the physical mapping of the plots are in part a consequence of the loose measurement rules of the legislation regulating the registration of property titles. In this respect, a proposal to make geo-referenced professional plans a pre-requisite for all registrations was recently introduced and its adoption is highly recommended.

Lease contracts are generally concluded in writing and sometimes certified by a public notary. Their registration with the RGP is required only if they are for more than three years or when one year of rent has been paid in advanced.<sup>94</sup> Possession of land by foreigners is not prohibited, however only Guatemalans by birth and enterprises that are majority owned by Guatemalans by birth may obtain title as a result of the adverse possession action.

The problems related to the security of land titles aggravate the situation of land disputes, which are common in urban and rural areas. These range from trespassing to squatting, inheritance-related conflicts,

<sup>89</sup> Article 123 of the Constitution.

<sup>90</sup> Decree 118-96.

<sup>91</sup> These include real estate located in urban zones and real estate for which rights were registered in the General Property Registry before March 1, 1956 if such estate is located in: (i) a 3-kilometer-long strip of land along the ocean; (ii) 200 meters around the lakeshores; (iii) 100 meters on either side of the navigable rivers; and (iv) 50 meters around any spring that serves as a source of water for the population (Art. 122 of the Constitution).

<sup>92</sup> Article 43 of the “Ley del Impuestos Único sobre Inmuebles”. New services at RGP allow sending these notices in electronic format.

<sup>93</sup> Municipalities are in charge of collecting property taxes (see taxation section).

<sup>94</sup> Article 1125 of the Civil Code.

### Box II.4. The modernization of land administration in Guatemala

Among the key reforms that have been carried out to implement the land-related objectives of the Peace Accords are the creation of a Cadastral Information Registry (RIC) and the modernization of the General Registry of Property (RGP).

Since its creation in 2005, the RIC has been carrying out an ambitious long-term programme to implement the cadastral registration of land, with the financial support of the World Bank, United Nations, and of many donor countries (assistance programmes PAT I and PAT II). The programmes started in 2005 in the periphery of the country.

As of November 2009, 28 of the country's 333 municipalities, representing about 20 per cent of its territory, had been declared "cadastral zones". These are the areas which have been subject to a detailed verification procedure. It begins with the analysis of the titles and their registration at the RGP, after which land is measured on the ground. This juridical and technical exam concludes with the designation of a plot number and certificate of regular or irregular cadastral plot. Irregular plots are those which have differences, encumbrances, counterclaims or are not registered in the RGP. The law provides a series of remedies for the regularization of some irregular plots, but is limited in scope. In this respect, a more comprehensive legislation would be necessary.

The RIC has also opened local offices and started a process of digital geo-reference mapping of the entire territory of Guatemala.

The RGP was created in 1877 as an autonomous entity in charge of the registration of rights on real estate and other identifiable movable goods and all acts and contracts which affect them, such as transfer of property, mortgages or court orders for the seizure of property. In the last decade, an integral review of the Registry took place and the process of modernization converted it into one of the most modern and efficient registries in the world, ranked as number 1 in Latin-America with registering property ranked 24 out of 183 in the World Bank's Doing Business 2010. The RGP has two main offices - in Guatemala City and in Quetzaltenango - and eleven smaller offices around the country. Records are maintained according to the "folio real" system, which tracks transactions as they relate to specific parcels of property identified with a number, and rights are assigned in chronological order following the "prior tempore potior jure" principle.

The modernization of RGP is a success story which started with the digitalization of registry books at the end of the 1990s, followed by regulatory changes in 2004. The key achievements of the modernization effort include:

- The digitalization of all paper documents and creation of a virtual library accessible online;
- The introduction of the electronic signature of documents;
- The implementation of customer-oriented information technology tools including an on-line tracking system of user requests, electronic submission of notices to municipalities, electronic request of certifications for delivery anywhere in the world, etc.;
- Improvements in the legitimacy and safety of registrations through several actions such as: a) special legislation to voluntary freeze assets that includes the use of biometrical fingerprints to prevent and avoid fraudulent transactions (Decree 62 of 1997); b) back-up of registered information is kept in Houston, Texas.

Source: UNCTAD interviews with RIC and RGP.

multiple titles, gaps and errors in public records, etc. The Peace Accords created in 1997 a Presidential agency (CONTIERRA<sup>95</sup>) to foster resolution of land-related conflicts by conciliatory means.

However, no specialized land courts exist and civil tribunals have jurisdiction over most land disputes. Cases can take as long as a decade and judicial resolution of disputes is regarded as inefficient. Parties to the disputes usually try to solve them by mutual agreement. In rural communities, a direct solution between parties is sought sometimes with the intervention of a community leader, lawyer or state institution (such as SAA - former CONTIERRA), while in urban areas, conciliation is often done by lawyers.

In conclusion, the lack of clear land titles creates uncertainty in the market, to the detriment of investment, precluding the right holder from access to credit and damaging tax collection (especially of property tax raised by municipalities). In this respect, recommendations include:

- To pursue the extension of the cadastral measurement and the identification of land rights throughout the country. The juridical and technical examination to which each plot is subject is crucial for the country's development. The conflicts arising from discrepancies in titles and errors in measurements require prompt and adequate solutions.
- To continue ongoing titling projects and provide clear ownership titles to people in rightful possession of land. In this respect, the adverse possession procedure should be streamlined. It is currently long, complicated and expensive. Therefore, many eligible owners of land do not use it.
- To introduce the mandatory registration of new land rights with the RGP, supported by adequate sanctions. The lack of financial penalties for not registering titles has fostered cheaper alternatives, such as private transactions which are not registered and result in multiple titles on the same plot of land. The lack of registration damages the whole system undermining security and transparency in the market.
- To improve accuracy on the physical characteristics of plots, professional plans should be mandatory for all registrations. The Government should make those services available at a reasonable cost, or for free in special cases.<sup>96</sup> Perceived complexity in procedures and high costs, for example of Notary fees or geo-referenced plans, are disincentives to formalize land rights. In particular people with very limited resources should receive legal and technical assistance to adequately fulfil these necessary requirements.
- To create special agrarian tribunals to solve land conflicts. The cadastral law provides sensible alternative dispute resolution remedies. However, in the event of a judicial dispute, civil courts lack the technical knowledge to solve certain situations, which require a careful review.

## 7. Governance

Following the Peace Agreements and the return to democracy, many important reforms have been launched to improve the functioning of the public sector in Guatemala. Yet, the investment climate is still affected by serious governance issues, including burdensome government regulations, high levels of administrative corruption and a slow and inefficient court system. The single most important deterrent to investment, however, is the security situation, not only due to the high cost it imposes on economic activities, but also to the impact it has on the image of the country as an investment destination.<sup>97</sup> This section reviews various elements of the country's governance and their impact on investment.

<sup>95</sup> Dependencia Presidencial de Asistencia Legal y Resolución de Conflictos de Tierra.

<sup>96</sup> By law, the cadastral implementation is free of charge until the declaration of regularity (or irregularity) or the cadastral plot, after which all services are paid for.

<sup>97</sup> The World Economic Forum's "Global Competitiveness Report 2009-2010" and the World Bank's Enterprise survey for Guatemala carried out in 2009 list crime as the most problematic factor for doing business in the country.

### **Red tape and corruption**

A clear correlation has been established between administrative efficiency and economic development. The regulatory burden directly impacts business costs and the capacity of companies to expand and hire employees. Complex administrative procedures are also an obstacle for entrepreneurs willing to join the formal economy, and are typically associated with high costs of administration for the State.

As it has been noted in other sections of this report, licensing processes in Guatemala can be very time-consuming and little use is made of e-government facilities and practices. A number of government institutions, such as the General Registry of Property or the Superintendence of Fiscal Administration have significantly improved their accessibility to the final user and the quality of their services through the use of IT-based solutions. This effort should be extended to other interfaces between the Government and the private sector. This includes in respect to company incorporation (see section I), construction permits, VAT reimbursement and phyto-sanitary certifications.

The use of electronic documents and automated processes can also prove a formidable tool to reduce the scope for discretion, falsifications and rent-seeking behaviour. In Guatemala, administrative corruption continues to be perceived as a serious problem by investors. However, the Government is making important progress in this area, and a sharp decrease in bribery has been reported by manufacturing firms (World Bank, 2008). Among the key actions in the official fight against corruption, it is worth mentioning:

- The ratification of the Inter-American Convention against Corruption and the United Nations Convention Against Corruption;<sup>98</sup>
- The introduction of a law against money laundering, according to which any deposit above \$10'000 has to be reported to the authorities;<sup>99</sup>
- New legislation on public access to information, protection of personal data, and obligation for all public entities to publish information including budget, applicable procedures, procurement contracts, etc;<sup>100</sup>
- The creation of a new Transparency Commission headed by the Vice-President of the Republic to coordinate government actions to fight corruption, including the creation of a Vice-Ministry of Transparency and Fiscal Evaluation within the Ministry of Finance, together with the Observatory on Public Spending aimed at promoting transparency of government spending, and probity of government officials;
- The creation of the Special Verification Intendancy (Spanish acronym IVE), which implemented a strategy to monitor bank accounts with the purpose of strengthening barriers to prevent the entry of money of doubtful origin in the national banking system, for example from corruption, kidnapping or drug trafficking;<sup>101</sup>
- The detention of high-ranking officials accused of corruption, including former President Alfonso Portillo;
- The joining of the Construction Sector Transparency Initiative (CoST), which aims to ensure transparency and reduce corruption in public sector construction projects.

<sup>98</sup> Decrees 15-2001 and 91-2005, respectively.

<sup>99</sup> "Ley contra el lavado de dinero u otros activos" Decree 67-2001, and its regulation.

<sup>100</sup> "Ley de acceso a la información pública" Decree 57-2008.

<sup>101</sup> Politically exposed persons (congressmen, mayors, governors, etc) voluntarily accept the monitoring of their bank accounts and those of their families to demonstrate that they have not received any illegal payments during their service. This as part of the framework of the Stolen Asset Recovery (StAR) initiative, launched jointly by the UN Office on Drugs and Crime (UNODC) and the World Bank Group (WBG) to implement the commitments of the UN Convention against Corruption. In 2009, there were 300 politically exposed persons under supervision, and it was estimated that at least 1,200 more were in the process of adhering voluntarily.

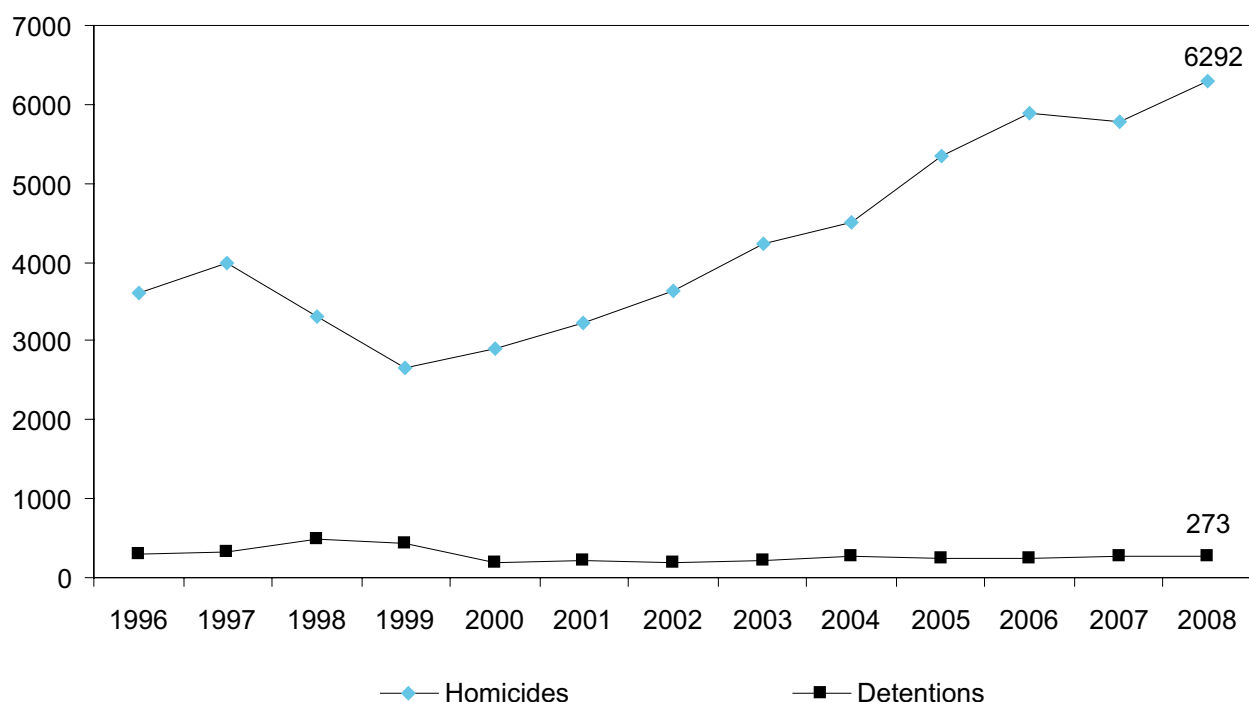
These improvements are reflected in Transparency International's corruption perception index, where Guatemala's ranking has improved for two consecutive years. In 2009 Guatemala was ranked 84 out of 180, only second to El Salvador among the Central America comparators.

In order to fight money laundering and comply with the recommendations of the Financial Action Task Force<sup>102</sup> (FATF), the Government is considering the elimination of bearer shares to only allow nominative shares. This would be a precondition to ratifying bilateral cooperation agreements on fiscal information exchange and detect banking transaction anomalies such as money laundering and tax evasion. Guatemala is not considered a tax haven but it is on the OECD grey list of non-cooperative countries. In March 2010 France included Guatemala, together with other Central American countries such as Costa Rica and Panama, on its black list of non-cooperative States and punished the profits or dividends of French subsidiaries in those countries with a tax increase of up to 50 per cent.

### Crime and violence

A United Nations study on crime showed that the northern part of Central America is the most violent region in America. In particular, Guatemala City is considered one of the most dangerous cities in the world.<sup>103</sup> As shown in figure II.1, homicides have doubled since the beginning of the century, while detentions are limited and constant. The reasons behind this high incidence of violence are complex and fall outside the scope of this report, which will only consider its impact on economic activity and investment.<sup>104</sup>

**Figure II.1. Number of homicides and detentions in Guatemala 1996 - 2008**



Source: National Civil Police.

The high homicide rates are mainly reported in non-rural regions of the country and are typically concentrated around the areas where economic activity is more dynamic, such as in the main cities and

<sup>102</sup> FATF is an intergovernmental body whose purpose is the development and promotion of national and international policies to combat money laundering and terrorist financing.

<sup>103</sup> A United Nations Study on Crime in Central America (2007) revealed the following rates of homicide per 100'000 habitants: El Salvador 59.91, Honduras 59.6 and Guatemala 44.24, followed by Colombia with 43.01. In 2006, Guatemala City reported 108 homicides per 100'000 habitants.

<sup>104</sup> Among many some of the causes which were mentioned are: social exclusion, absence of rule of law, drug-trafficking, organized crime and gangs.

along the borders (UNDP, 2007). The rise of criminality, the low number of condemnation sentences<sup>105</sup> and extensive media coverage of the issues have created a perception of impunity among the population. Resort to direct justice by the individuals directly or indirectly affected by violence is frequent and further contributes to the growing security problem.<sup>106</sup>

### **Box II.5. The International Commission against Impunity in Guatemala**

CICIG was created through an agreement between the United Nations and the Government of Guatemala, which entered into force on 4 September 2007. In 2009, the Government requested to extend the original two-year mandate of the Commission for another two years.

The key objective of CICIG is to support, strengthen and assist Guatemalan State institutions responsible for investigating and prosecuting crimes allegedly committed by illegal security forces and clandestine security organizations, as well as other criminal conduct related to these entities. While remaining an international body, the Commission also investigates and promotes criminal prosecutions within Guatemala's national justice system. In this respect, it has had an active participation in high-impact cases, including the assassination of Rodrigo Rosenberg, a prominent Guatemalan lawyer murdered on 10 May 2009, and the allegations against former president of the Republic, Alfonso Portillo, accused of corruption in Guatemala and money laundering in the United States of America.

The Commission has also submitted two sets of legal reform proposals, including proposals on issues such as: (a) arms and ammunitions; (b) the recourse to protect Constitutional rights ("amparo");<sup>107</sup> (c) the law on the immunities of public officials; (d) criminal procedures; (e) the use of audiovisual testimony of witnesses and experts; (f) witness protection; (g) the effective collaboration of defendant-informants; (h) legislation on trafficking in persons; (i) the fight against corruption; (j) disciplinary measures in the criminal justice sector; and (k) international judicial cooperation in criminal matters.

The Commission's legal reform proposals led to the approval of a new Law on Arms and Ammunitions, Strengthening of Criminal Prosecutions, Criminal Jurisdiction in High-Risk Proceedings. This law establishes a legal basis for specialized courts with expanded jurisdiction to hear high-impact cases. Another result is a reform of the Law against Organized Crime, which allows for a reduction of sentences for members of criminal groups who collaborate in the prosecution of organized crime cases.

*Source:* Report of the Secretary-General to the United Nations General Assembly, 23 September 2009.

Apart from crimes against persons, theft and crimes against property are common and affect all sectors of the economy. A United Nations study on the cost of violence in Guatemala indicated that efforts to combat civilian insecurity in 2005 cost approximately 7.3 per cent of GDP (UNDP, 2006). The lack of effective government actions and adequate institutions has created a private security market (a phenomenon which is common throughout Central America). Many investors reported using the services of private security companies, especially to protect cargo shipments. The National Civilian Police force is estimated at around 19'100, while around 150'000 agents work in the 147 registered private security companies.<sup>108</sup>

The cost of such security for business is high. On top of hiring private security agents, many companies install alarms, cameras and use other preventive measures like GPS finders, armoured vehicles, reinforced

<sup>105</sup> According with 2008 statistics, only 8 per cent of the cases concluded with a sentence while 73 per cent of the cases were solved through other means.

<sup>106</sup> The perception of lack of justice has increased the direct application of punishments by the communities, sometimes even leading to death of the accused criminals through "linchamientos" (lynching). In 2005, 77 cases of "linchamiento" were reported in 11 departments of the country which resulted in three murdered persons. However, the following year the number increased to 611 in 16 departments (10 persons were murdered).

<sup>107</sup> The law (Decree 1-86) allows a very broad scope of application of such recourse, which is frequently abused to delay judicial procedures.

<sup>108</sup> Ministry of Governance.

windows, etc. The World Bank estimated that additional costs to prevent crime for enterprises range from 3 per cent of sales for small firms to 0.9 per cent for larger firms (World Bank, 2008). For exporting firms, the direct losses related to theft in Guatemala are 10 times higher on average than those for exporters in Chile or Colombia.

In this dramatic context and amid a generalized concern about public insecurity and crimes, the Government has taken, among others, the following actions:

- Created a National Security Council, where relevant institutions dealing with criminal problems meet once a month to coordinate actions;<sup>109</sup>
- Approved a national agreement for security which recommends 101 actions to improve the security situation, such as the creation of a Ministry of Security, legislative changes to improve the penitentiary system, integration of a Commission to reform the police force, and the approval of criminality policy;
- Requested the collaboration of the United Nations to establish the International Commission against Impunity in Guatemala (box II.5).<sup>110</sup>

Successfully addressing such a complex problem will require extensive efforts. Government actions in this area have not been effective to date. Guatemala should follow-through on the implementation of the recommendations of the International Commission against Impunity in Guatemala (CICIG) and consider following the example of countries with similar problems, such as Colombia, to increase preventive actions and local programmes to improve the respect of human rights and avoid the involvement of economically inactive population in organized crime and gang activities. An improvement in the security situation is an imperative for development, in particular if Guatemala wants to successfully profile itself as a regional hub for exports.

### **Commercial justice**

The Peace Agreements started a process of modernization of the judicial system, which has resulted in: the institution of Peace Courtrooms in each municipality and mobile Peace Courtrooms to reach remote areas; the modernization of the courts' infrastructure and equipment; the creation of administrative centres of justice;<sup>111</sup> the training of judges (including via the creation of a School of Judicial Studies); an enhanced inter-institutional cooperation; and the successful implementation of alternative dispute resolution (ADR) mechanisms (box II.6).

Notwithstanding such progress, Guatemalan courts are routinely rated among the slowest in the world. For example, according to the Doing Business Indicators of 2011, a standard debt collection case, which is a minor commercial dispute, would take 1'459 days to resolve, more than double the average for Latin America and the Caribbean and significantly longer than in any comparator country in Central America (table II.7).

<sup>109</sup> Decree 18-2008 contains the framework law for the National Security System and regulates the National Security Council.

<sup>110</sup> CICIG was created through an agreement between the United Nations and the Government of Guatemala, which entered into force on 4 September 2007, with a two-year mandate. In 2009, the government requested to extend the mandate of the Commission for two years.

<sup>111</sup> The Administrative centres of justice group in one place the different entities involved in judicial procedures, from the police to the judge, the public defence and public prosecutor can be found in one place.

**Table II.7. Enforcing contracts in Guatemala and selected comparators, 2009**

Region or economy	Procedures (number)	Time (days)	Cost (% of claim)
Costa Rica	40	852	24.3
El Salvador	30	786	19.2
<b>Guatemala</b>	<b>31</b>	<b>1'459</b>	<b>26.5</b>
Honduras	45	900	35.2
Nicaragua	35	540	26.8
Latin America & Caribbean	40	707	31.2

Source: World Bank Doing Business Indicators 2011.

### **Box II.6. Alternative dispute resolution in Guatemala**

The law allows all matters subject to transaction to be solved through alternative dispute resolution (ADR) mechanisms. To improve the efficiency of dispute resolutions the Judicial Organism has opened 76 mediation centres around the country. At these centres, the parties bring their civil, family, commercial, labour and even criminal claims. Commercial disputes represent only about 2 per cent of the claims. It is also important to mention that private ADR administration centres are also available for commercial disputes at the Chamber of Commerce and the Chamber of Industry.

At the centres, parties receive the assistance of a mediator free of charge. Acting under confidentiality and following a simple oral procedure, the mediator helps the parties to the dispute to find a peaceful solution to their problem. When the parties reach a mutually satisfactory agreement, they write an accord, which is later validated by a judge. If they cannot reach a solution they can take their claims to court.

These ADR mechanisms are a useful tool to clear the burden of tribunals, especially for small claims. They have successfully mediated at least 50 per cent of the cases presented before them, suggesting that more needs to be done to foster the use of such mechanisms in the commercial area.

Source: Resolution of Conflicts Unit, Judicial Organism, 2010.

As mentioned in other sections of this report, a key problem in this regard is the lack of specialized tribunals in areas such as commercial justice or land. All relevant procedures are dealt within the civil jurisdiction, often overburdened with cases of different nature. A second issue often mentioned during the UNCTAD interviews with both representatives of the administration and of the private sector is the frequent rotation of judges, which also affects the judges' competence on specific topics and the speed of justice. These issues should be reviewed to establish specialized commercial tribunals. At the same time, the authorities should foster the use of ADR mechanisms in the commercial field.

### **Customs operations**

Given Guatemala's geographic location, its customs process a large volume of commercial traffic. Good progress has been achieved in recent years in streamlining the functioning of customs services in line with the progressive liberalization of Guatemala's trade regime. Since 2008, Guatemala's customs regime has applied the Uniform Central American Customs Code (CAUCA IV) and its related regulations (RECAUCA). Guatemala has also adopted the Central American Customs Valuation Regulations with the intention of implementing the provisions of the WTO Customs Valuation Agreement (WTO, 2010).



The customs units have been equipped with computers since 2001 and customs tariffs and taxes are paid directly through local banks. The SAT is the entity responsible for customs administration and the customs declaration forms can be downloaded from its website. They are completed and returned electronically. The SAT also recently adopted a computer system to handle the digital management of documents, workflows and a tax current account for the purposes of paying internal and foreign trade taxes (called SAQB'E).

The SAT verifies the information contained in customs declarations on a random basis and the same applies to physical inspection of goods. The inspection and immediate verification of goods (physical and documentary examination) are based on a risk assessment model that takes into account the type of goods, the track record of the importer and a random component. According to the authorities, some 40 per cent of imports falling under the high risk category (red) are physically inspected in a process taking approximately from 18 to 24 hours. Goods in the low risk category (green) are cleared within approximately 5 hours.

International comparative data show an improvement in the customs operations (table II.8). Though up to 10 documents may be needed for imports, depending on factors such as the origin and type of the goods, the time to complete an import procedure fell by more than half, from 36 days in 2006 to 17 days in 2010. Customs clearance time and cost are below the Latin America and Caribbean average, though Guatemala still lags behind more efficient neighbours such as El Salvador or Costa Rica.

**Table II.8. Customs clearance time and cost, Guatemala and selected comparators**

Economy	Documents to export (number)	Time to export (days)	Cost to export (\$/container)	Documents to import (number)	Time to import (days)	Cost to import (\$/container)
Costa Rica	6	13	1'190	7	15	1'190
El Salvador	8	14	845	8	10	845
<b>Guatemala</b>	<b>10</b>	<b>17</b>	<b>1'182</b>	<b>10</b>	<b>17</b>	<b>1'302</b>
Honduras	6	19	1'193	10	23	1'205
Nicaragua	5	26	1'140	5	26	1'220
Latin America & Caribbean	6.6	18	1'228.3	7.1	20.1	1'487.9

Source: World Bank, Doing Business 2011.

## 8. Competition policy

The reduction of regulatory barriers for FDI is not necessarily followed by a reduction in private barriers and anticompetitive behaviour of established firms. At the same time, the entry of transnational corporations will not necessarily lead to lower prices, improved quality or increased consumer choice. For this to happen, liberalization measures need to be complemented with competition rules that will promote market efficiency, prevent restrictive business practices, ensure market contestability and enhance consumer welfare.

Guatemala made a clear pro-market choice long ago. However, the lack of a clear competition policy, and the absence of a general competition law, let alone a competition agency, have resulted in a large number of anticompetitive behaviours and high market concentration in various sectors, which negatively impacts on the level of prices and on consumers. Box II.7 summarizes the findings of various studies providing examples of anti-competitive practices in different sectors of the economy. Chapter III discusses in more detail the risks associated with actual or potential anti-competitive practices in the construction and electricity sectors.

Misperceptions on the objectives and benefits of competition policy such as the belief that a competition agency would distort the proper functioning of the market are still widespread. Although international commitments to develop a competition policy and avoid anticompetitive business practices have been taken under several free trade agreements,<sup>112</sup> to date Guatemala is the only country in Central America, and one of the few countries in Latin America, without a general competition law.

The Constitution<sup>113</sup> prohibits monopolies and mentions basic principles of competition. Certain sector-specific laws (such as the General Law on Telecommunications, the Hydrocarbon Commercialization law, the Intellectual Property Law and the Bank Law) have more detailed rules on competition issues. The relevant agencies in charge of overseeing such sectoral competitive practices, however, have no active powers to initiate investigations. The Commercial Code contains a whole chapter on the protection of competition,<sup>114</sup> while the Criminal Code<sup>115</sup> outlines illegal conducts, such as stockpiling or hoarding of goods, and determines sanctions. These, however, have never been implemented.

### Box II.7. Examples of restrictive business practices in Guatemala

**The sugar sector:** distribution monopoly - although there are 17 sugar plants, there is only one distributor which sets the prices for the consumers.

**The canned beans sector:** high market concentration - five plants participate in the market, however two of them report having a market share of 92.6 per cent.

**The beer sector:** is a duopoly - between the national producer and a Brazilian brewery in alliance with national soft drinks bottling company. Prior to 2003 the national company controlled 95 per cent of the market, after the entrance of FDI, sale prices were slashed by 35 per cent.

**The liquor sector:** classic case of oligopoly between four domestic companies. The market is also protected by high import tariffs on rum (40 per cent) and other sugarcane-based liquors (30 per cent).

**The energy sector:** energy generation is competitive, but distribution tariffs for small users have been gradually increasing and an injection of competition is needed at the distribution level (see chapter III).

**The construction sector:** most segments are characterized by the presence of dominant suppliers. For instance, the market shares of the incumbents in the cement and steel industry amount to approximately 80 per cent respectively, the main player in the aggregates sector holds a market share of 50 per cent and there is only one supplier of bitumen.

**Poultry sector:** high concentration - one company controls 75 per cent of poultry production and the remaining 25 per cent is produced by a group of small farmers.

Source: UNCTAD, ECLAC (2007) and CUTS (2006).

A modern Consumer Protection Law has been in force since 2003.<sup>116</sup> It established a consumer protection agency (Dirección de Atención y Asistencia al Consumidor – DIACO) within the Ministry of Economy. The entity, which acts largely as a mediator, reports that since its establishment, the number of

<sup>112</sup> Including with United States (DR-CAFTA), Chile, Panama, and Dominican Republic. Also, in the framework of the General Treaty on Central American Economic Integration, the Protocol of Guatemala (1993) confirmed the need of having a legal framework to regulate competition in the internal market of each member.

<sup>113</sup> Articles 119h) and 130 of the Constitution.

<sup>114</sup> Commercial Code articles 361 to 367 on protection to free competition, and article 251 on mergers.

<sup>115</sup> Articles 340 and 341 of the Penal Code.

<sup>116</sup> Decree 006-2003 :“Ley de Protección al Consumidor y Usuario”.

complaints received from consumers has increased dramatically, also due to the increased awareness on consumer rights and the way to protect them. In line with the experience of other countries, the agency is programmed to receive independent prosecuting powers (a number of years after its establishment). Guatemala is also a member to the Central American Treaty on Unfair Trade Practices. In line with its WTO commitments, it established a Division of Economic Integration within the Ministry of Economy as the entity in charge of conducting the investigations concerning unfair trade practices.

A Directorate for the Promotion of Competition exists, with very limited functions and resources, within the Vice-Ministry of Investment and Competition of the Ministry of Economy. Among its functions, the Directorate studies the structure and functioning of the markets of national products and highlights some competition issues. An example is a recent study on wheat flour<sup>117</sup> which showed high concentration in the market. The Directorate, however, has no real investigative or enforcement powers.

Several draft competition laws, based on UNCTAD's model competition law have been submitted to Congress since 2000.<sup>118</sup> However, none of them received the necessary political support. The latest draft contains substantive rules on agreements between competitors (horizontal agreements), agreements between non-competitors (vertical agreements), abuse of dominant position on the market and control of high impact concentrations (mergers). On the institutional side, however, the current draft would leave the competition agency at the dependence of the Ministry of Economy, which would not shield it from political pressures as needed.

Guatemala faces severe competition issues, which undermine the effectiveness of liberalization measures and encourage inefficiencies and market distortions. The Constitution provides a solid basis to build a competition policy; however, political support is needed to adopt a competition law and establish the necessary institutional framework, in accordance with Guatemala's international commitments. UNCTAD has been supporting Guatemala in its efforts to establish a competition law and in 2003-2004, a study was prepared under the COMPAL Programme<sup>119</sup> emphasizing the need for a competition law to analyze and sanction the presumed anti-competitive practices. This should be a priority for the country's development and UNCTAD stands ready to assist the Government of Guatemala in sensitizing the country authorities, including the legislative body on competition issues and in designing and implementing an effective competition policy.

## 9. Environment

Environmental sustainability is one of the Millennium Development Goals. Adequate environmental regulations are essential to achieve the goals and are also an important aspect of business regulation, given their economic and social implications on project development. Business projects, especially in sectors which rely on natural resources such as energy and mining, require clarity on the environmental and social standards applicable to their operations. In Guatemala, modern legislation is however accompanied by a severe lack of institutional capacity for its enforcement.

The Constitution of Guatemala contains provisions on the protection of the environment<sup>120</sup> and the country is party to more than 75 international treaties on environmental matters. In 2002, the Ministers of Environment of Belize, Costa Rica, El Salvador, Honduras, Guatemala, Nicaragua and Panama took the political agreement to modernize and strengthen the systems of environmental impact assessment (EIA) and approved a Central American Plan of Action which aims at harmonizing EIA in Central America under the

<sup>117</sup> [http://www.mineco.gob.gt/Espanol/Noticias/mt\\_nt\\_05062009\\_ic](http://www.mineco.gob.gt/Espanol/Noticias/mt_nt_05062009_ic)

<sup>118</sup> Draft laws presented to Congress: a) "Ley para la Custodia de la Competencia" (2004); b) "Ley para la Defensa de la Libre Competencia" (2002) c) "Ley de Promoción de los derechos de los Consumidores, los usuarios y de la Libre Competencia" (2000)

<sup>119</sup> COMPAL Programme. Strengthening institutions and Capacities in the area of Competition and Consumer Protection in Latin America. Cases of Plurinational State of Bolivia, Costa Rica, El Salvador, Honduras, Guatemala, Nicaragua and Peru. UNCTAD/DITC/CLP/2004/3. UN. Geneva, New York 2005.

<sup>120</sup> Articles 60, 64, 96, 97, 119, 125 to 128 of the Constitution.

supervision of the Central American Commission of Environment and Development (CCAD). Moreover, CAFTA-DR was the first free-trade agreement which included an environmental chapter.

Guatemala was also a pioneer in the region in adopting modern environmental legislation (Decree number 68 of 1986). It is only in 2000, however, that the Ministry of Environment and Natural Resources<sup>121</sup> (Spanish acronym MARN) was created and only in 2003 that the first evaluation, control and monitoring regulations were approved (Decree 23-2003). These have since been subjected to several modifications and the latest version is contained in Decree 431 of 2007 and its modifications.

Delegations of MARN are present in each of the 22 departments of the country and the Ministry has implemented several measures to improve its administrative procedures and interface with the public, including opening of a single window to provide information, publishing of user guides as well as terms of reference on how to conduct environmental impact assessments on different types of projects. MARN has also concluded cooperation agreements with other public entities responsible for high environmental impact sectors, such as the Ministry of Energy and Mining.

According to the law, all projects, works, industries or any other type of activities that may deteriorate renewable natural resources, the environment or modify the landscape, require an environmental impact study.<sup>122</sup>

In line with international best practices, the regulation requires different types of environmental evaluations based on the scope and potential impact of the project. The determination of the project category is based on objective criteria and a list of different project types as contained in Government Agreement 134 of 2005. This is summarized in table II.9.

All projects are required to present MARN with an initial environmental evaluation and a duly notarized sworn declaration. These documents help MARN determine the category of the project, the subsequent environmental evaluation that should be submitted and the eventual inspection.<sup>123</sup> Once all conditions set by MARN have been fulfilled, a resolution of approval that leads to an environmental licence is issued. The requirements typically include submitting an environmental performance bond (*fianza de cumplimiento de los compromisos ambientales adquiridos a través del EIA*),<sup>124</sup> which is renewed every two years throughout the existence of the project and in some cases should be complemented by an environmental insurance.

Public participation is encouraged after the presentation of the initial environmental evaluation and particularly when environmental impact studies are required. Depending on the terms of reference applicable to the specific case, a public participation plan for the whole cycle of existence of the project may be requested. MARN together with the proponent of the project publish the project proposal and any person affected by the project may present observations 20 days after publication. In its final resolution of the environmental evaluation, MARN is called to consider these observations, opinions or oppositions.

MARN may also apply administrative sanctions (warnings, suspensions, or fines) when the conditions of the licence are not respected. Any person may present claims for environmental violations, and according to MARN's website, 667 claims were presented in 2009.<sup>125</sup> When these violations are constitutive of a crime against the environment according to the criminal code,<sup>126</sup> they are responsibility of the Environmental

<sup>121</sup> Decree 90-2000 Law on the creation of MARN.

<sup>122</sup> Article 8 Law of the protection and improvement of the environment.

<sup>123</sup> According to article 12 of the Regulation on the environmental evaluation, control and monitoring, tools for environmental evaluation may include: a) Strategic environmental evaluation; b) initial environmental evaluation and environmental self-evaluation; c) Study on evaluation of environmental impact; d) evaluation of environmental risk; e) evaluation of social impact; f) environmental diagnostic; g) accumulative effect evaluation.

<sup>124</sup> Article 64 Regulation: Category "C" projects do not need to pay this bond.

<sup>125</sup> [http://www.marn.gob.gt/sub/portal\\_legal/menus/2009a.html](http://www.marn.gob.gt/sub/portal_legal/menus/2009a.html)

<sup>126</sup> Articles 346, 347 « A », 347 « B », 347 « C », 347 « E » of the Criminal Code.

Prosecutor Office (“Fiscalía de delitos contra el ambiente”) and judicial procedures are followed at Criminal Courts.

**Table II.9. Environmental evaluation categories**

Category	Description	Examples	Environmental Impact Evaluation
<b>A</b>	Potentially high environmental impact or environmental risk.	<ul style="list-style-type: none"> <li>- Mega projects</li> <li>- Mines</li> <li>- Generation of electricity</li> <li>- Experimental projects with products derived from biogenetic process in plants or animals</li> </ul>	<ul style="list-style-type: none"> <li>- Environmental impact study done by registered consultant following specific terms of reference available for mining, hydroelectric projects, etc.</li> </ul>
<b>B</b>	Moderate potential environmental impact or environmental risk. It has subdivisions B1 for high to moderate and B2 for moderate to low impact or risk.	<ul style="list-style-type: none"> <li>- Agriculture projects of more than 500 hectares</li> <li>- Geological prospecting</li> <li>- Textile manufacture industries: large enterprises require B1, while medium enterprises require B2.</li> <li>- Design, construction and operation of substations of electrical energy.</li> <li>- Design, construction and operation of hotels, restaurants, bars, etc.</li> </ul>	<ul style="list-style-type: none"> <li>- B1: have to follow the same requirements of category A projects.</li> <li>- B2: new projects should present an initial environmental evaluation, while existing activities should present a low impact environmental diagnosis. In both cases the evaluation should be complemented with an environmental management plan done by a registered environmental consultant.</li> </ul>
<b>C</b>	Low environmental impact and environmental risk	<ul style="list-style-type: none"> <li>- Ecological agricultural projects</li> <li>- Manufacture of non-alcoholic beverages by Small enterprises.</li> <li>- Recycling activities by small enterprises.</li> <li>- Design, construction and operation of residential projects of less than one hectare.</li> </ul>	<ul style="list-style-type: none"> <li>- Initial environmental evaluation or low impact environmental diagnosis for existing activities.</li> </ul>

Source: UNCTAD and Government Agreements 134-2005 and 431-2007.

Despite a modern general legal framework and efforts to have talented and dedicated officers, MARN lacks adequate human and financial resources to enforce the environmental regulations. In the interviews conducted by UNCTAD in the field research for this report the following issues were pointed out by investors, government authorities and non-governmental organizations:

- a) There is a lack of institutional capacity given the small size of the Directorate in charge of Environmental Evaluations (Spanish acronym DIGARN), which is composed only of 20 persons;
- b) Environmental assessments are often sub-standard; for example in the case of hydroelectric projects certain important environmental security standards, such as the seismic criteria, are not a regular part of the analysis;
- c) MARN has very limited monitoring capacity, with only five inspectors for the entire country;
- d) MARN does not dispose of sufficient monitoring and enforcement powers to close down activities which present eminent risks to the environment.
- e) MARN’s institutional weakness is one of the key reasons behind the opposition of local communities towards energy, mining and infrastructure projects (see chapter III).
- f) More capacity-building is required to implement Strategic Environmental Evaluations.

The institutional weakness of MARN has been recently acknowledged by the Environmental Report of the Government of Guatemala as one of the most important challenge towards improving environment protection in the country (Bouroncle, 2009). The Government should give priority to addressing this issue, which bears many implications for the social, economic and environmental development of the country.

## 10. Intellectual property protection

Guatemala has a long tradition in the protection of industrial property, which started in 1886 with the creation of the first patent office. Copyright protection started much later, in 2000, and the entire intellectual property (IP) system was recently overhauled to comply with the requirements of the IP chapter of CAFTA-DR, which introduced high standards of protection of intellectual property rights.

Guatemala is party to the main international treaties for the protection of intellectual property rights (table II.10) and has concluded several free trade agreements which contain a chapter on intellectual property rights. Among these, the most important one is CAFTA-DR, which in 2006 raised the standard of intellectual property protection to include new provisions including protection of encrypted program-carrying satellite signals; expanded protection for patents and undisclosed information; improvements to the registration systems, enforcement measures and remedies to increase the fight against piracy. CAFTA-DR also set an obligation for the Government to ratify several intellectual property agreements.<sup>127</sup>

The national legislative basis for IP protection can be found in the Constitution, while substantive regulation is contained in the Industrial Property Law (Decree 57 of 2000) and in the Copyright Law (Decrees 33 of 1998 and 56 of 2000). Their key provisions include:

- *Patents* are generally granted for 20 years;
- *Undisclosed information* (test data) for the marketing of pharmaceuticals is protected for 5 years and 10 years for agricultural chemicals;
- *Compulsory licences* may be granted by the Intellectual Property Registry, after adequate compensation, in cases of: emergency, national security and public health or to remedy anticompetitive practices. No such licence has been granted;
- *Trademark* registry is valid for 10 years renewable indefinitely for successive 10-year periods. All signs, including sounds or scents, and geographical indications which distinguish a product or service may be registered as trademarks;
- *Denominations of origin* may be registered with indefinite duration;
- *Economic rights* are protected for 75 years, while moral rights are indefinite;
- Acts that violate the *effective technological measures* used to protect copyrights are prohibited (especially in the audiovisual and software fields).

**Table II.10. Multilateral treaties on intellectual property rights in force in Guatemala**

TREATY	OBJECT OF PROTECTION	ENTRY INTO FORCE
Bern Convention	Copyright (literary and artistic works)	July 28, 1997
Budapest Treaty	International recognition of the deposit of micro-organisms for the purposes of patent procedure	October 14, 2006
Nairobi Treaty	Protection of the Olympic symbol	February 21, 1983
Paris Convention	Industrial Property (patents, trademarks, industrial designs)	August 18, 1998
Patent Cooperation Treaty (PCT)	International patent application	October 14, 2006
Geneva Convention	Producers of phonograms against unauthorized duplication	February 1, 1977
Rome Convention	Performers, Producers of Phonograms and Broadcasting Organizations	January 14, 1977
WIPO Copyright Treaty (WCT)	Copyright of computer programs and databases	February 4, 2003
WIPO Convention	Constituent instrument of the WIPO	April 30, 1983
WIPO Performances and Phonograms Treaty (WPPT)	Performances and Phonograms	January 4, 2003
WTO - TRIPS Agreement	Trade related aspects of intellectual property rights	July 21, 1995

Source: World Intellectual Property Organization.

<sup>127</sup> CAFTA-DR implementation act (Decree 11-2006).

Holders of intellectual property rights can protect them through administrative, civil and criminal proceedings. Civil actions may also be solved through alternative dispute resolution methods such as conciliation and arbitration.

Detailed rules regulate the implementation of preliminary or permanent injunctions, civil actions and determine the amount of damages in cases of violation. For instance, right holders may request border measures, and law enforcement agencies have authority to seize suspected pirated and counterfeit goods in the country or at the border, the equipment used to make or transmit them and any documentary evidence. Courts have the authority to order the destruction without compensation of counterfeit goods and machines used to produce them.

The Ministry of Economy is the entity in charge of policymaking, while the Intellectual Property Registry is the administrative agency in charge of delivering patent, trademark and copyright titles. This registry has online services and coordinates actions to improve the enforcement of rights, for example working with the SAT to sign a cooperation agreement and to share its IP database to fight smuggling.

In 2001 a special prosecutor's office for intellectual property offences ("*fiscalía de delitos contra la propiedad intelectual*") was created in the attorney general's office to enforce the protection of intellectual property rights. However, the office has limited resources (only 3 prosecutors, 4 assistants and 3 officials). Moreover, though civil servants and judges have received some training on intellectual property issues, this is often lost due to the mentioned frequent rotation in the judicial personnel who receives it. In 2009, around 200 cases were received by the special prosecutor's office. Most of them were solved through alternative dispute resolution methods after adequate compensation of damages. Twenty cases were taken to court and two received a condemnatory judicial sentence.

The creation of the special prosecutor office is a good step forward in the enforcement of IP rights. However, the authorities recognize that better coordination is needed between this office, the police and the other institutions in charge of IP policy and enforcement. Specific recommendations to improve the IP protection include to:

- Follow through on the implementation of Guatemala's obligations under international instruments and CAFTA<sup>128</sup> with due regard to the interest of SMEs, farmers and traditional communities in order to ensure access to technology products, such as medicine and educational materials;
- Coordinate with the private sector advocacy campaigns to train IP societies and right holders on how to enforce their IP rights and encourage a culture of respect of IP rights, in particular for copyright and copyright-related rights;
- Invest in capacity-building of public officials at all levels, from police to judges, to strengthen institutions and improve enforcement. At higher levels, it would be important to provide scholarships linked with a minimum of three years of public service;
- Endeavour to coordinate all the relevant institutions for the enforcement of IPR protection. Cooperation and communication between the police force, customs, judicial authorities, the intellectual property register and the attorney General should be institutionalized in a committee which should meet at least once a month to implement a common strategy.

<sup>128</sup> Guatemala is expected to ratify the Convention Relating to the Distribution of Programme-Carrying Signals Transmitted by Satellite (Brussels Convention, 1974), the Trademark Law Treaty (1994), and the International Convention for the Protection of New Varieties of Plants (UPOV Convention 1991).

## C. Assessment

The assessment of the legal and regulatory framework for investment in Guatemala has resulted in the following salient findings:

1. Guatemala's investment framework has long been liberal and supportive of private sector development. The country also has a long-standing tradition of openness to FDI. Very few restrictions apply to the entry of FDI, and non-discriminatory treatment of foreign investors is enshrined in the law and enforced. An extensive BITs network is in place, which adds to the protection provisions offered in the foreign investment law. In these respects, Guatemala can legitimately claim to offer one of the most open investment regimes in Latin America.
2. The Commercial Code and the Foreign Investment Law should nonetheless be revised in order to adopt a more standard definition of companies with foreign capital, based on the notion of control by the foreign investor and ownership of the capital, rather than the place of incorporation. Not considering the actual ownership of the capital, or control over the company's activities, can pose a transparency problem, particularly in a country where bearer shares are widespread practice. Moreover, the current nationality criterion makes it difficult to implement the sectoral limitations on FDI established in the law.
3. A revision of FDI law is also recommended in order to: 1) remove inconsistencies with other laws, and hence the potential for unnecessary disputes with the State, and 2) strengthen the institutional setting in charge of the design and implementation of investment policy, investment promotion and dispute prevention.
4. The reform process started in the 1990s has continued to date and led to the adoption of several modern laws in accordance with best international standards. These include the laws on foreign exchange, environment and intellectual property. However, it neglected to introduce policies that are critical to ensure the proper functioning and regulation of the market, in the interest of the consumers, of the population at large and of economic development. Primary among these is the absence of a competition policy and of an agency mandated to prevent and sanction anti-competitive behaviour of market agents. At the same time, important government institutions are often weak and under-resourced to comply with their mandates, the environmental agency being a most striking example.
5. Security is the major problem affecting investors and the FDI attraction potential of Guatemala. This is recognized, but the authorities still need to find effective tools to address this national emergency. Aggravating the situation is the lack of efficiency of the judiciary system, which extends to commercial justice.
6. The tax policy is partly to blame for the low spending capacity of the Government and the ensuing institutional weaknesses described above. As it stands, the corporate income tax regime favours tax engineering, arbitrage and evasion. It also discourages start-ups and leads to abuse of the available incentive schemes. An integral reform is necessary.
7. The administrative burden on business is excessive and calls for a rethinking of regulations and their administration. The abuse of the notary function and of fiscal stamps in various permitting processes, including company establishment and the entry of foreign labour, are a case in point.
8. Many institutions have adopted innovative IT solutions which resulted in lower operational costs, greatly improved processes and easier interface between the public administration and the final users, be it business or consumers. The modernization of SAT, customs and of the GRP are very encouraging examples. Their lessons should be applied in other areas of the public administration which are still overly bureaucratic in nature and are resistant to innovation.



### III. ATTRACTING FDI IN ELECTRICITY, ROADS AND MINING

The Government of Guatemala has identified electricity, roads and mining as priority sectors for FDI and requested UNCTAD to assist in providing elements for an investment attraction strategy in these sectors.

Quality infrastructure is a necessity for socio-economic development and FDI, when aligned to a country's development goals, can play an important role as a source of finance, expertise and innovation. In the case of the electricity sector, Guatemala has put in place a regulatory framework which has led to a successful privatization and subsequent FDI attraction, as well as positive outcomes in terms of expansion of installed capacity, quality of distribution services and electrification coverage in the country. Although some regulatory issues still need to be addressed and the impact of increased investment on the price of electricity is yet to materialize, FDI will continue to play a central role in the future of the sector.

The Government aims to replicate the positive results achieved through the involvement of FDI in electricity in terms of the expansion and quality of infrastructure to its road network. Although potential for FDI attraction to the sector is large, the regulatory and institutional framework for launching a full-fledged road concession programme is yet to be put in place. Up until now, the participation of the private investors in this sector has been minimal. This could change in the future, provided that a number of issues are addressed.

Aside from the Government's goal to develop infrastructure, Guatemala also aims to raise its profile as a mining country. The country has great potential in mining – particularly considering its proven deposits of gold and nickel – which is significantly underdeveloped. A weak regulatory framework in this sector has resulted in: 1) few benefits from mining; and 2) the opposition of local communities to new investments. Sensitive social issues need to be addressed for the sector to reverse its current unfavourable situation and reach its potential.

This chapter will separately assess the priority sectors providing a brief background that summarizes the main objectives for each. It will then present a sector analysis that covers the key legal, institutional and other relevant issues before offering specific recommendations. Finally, the chapter will provide some thoughts on the implications for FDI promotion that arise from the recommendations of each sector.

#### A. Electricity

##### I. Background and objectives

Between 1969 and 1990, the State acted as entrepreneur in all activities of the electricity sector, as the Instituto Nacional de Electrificación (INDE) and the Empresa Eléctrica de Guatemala (EEGSA) shared generation, transmission and distribution responsibilities. In the early 1990s, the sector underwent major policy reforms. A long process was initiated and implemented by different administrations to promote private generation and co-generation. Private sector participation was first allowed in generation to encourage short-term investment and capacity additions that would decrease the prospects of supply shortages.<sup>129</sup>

The first successful private investment took place in 1992. A consortium of investors, led by the United States' firm Enron, secured a contract with EEGSA to build and operate a 110 MW thermal power plant, the Puerto Quetzal Power (PQP). In the following years, a policy of growth through private participation was put in place as the Government went on to negotiate additional contracts with the private sector, including foreign investors. As a result for instance, EEGSA and INDE had executed, by 1998, twenty generation

<sup>129</sup> At the time, low funding capabilities for expansion of the electricity system, severe droughts and growing demand resulted in extended blackouts of up to eight hours daily.

contracts through long-term power purchase agreements (PPAs), which translated into 600 MW of installed capacity that fully came into operation by 2002.

The long-term PPAs included “take-or-pay” clauses, where the buyer is obliged to pay for an agreed energy quantity even if it is not used; fuel indexation based on international oil prices; and generous fiscal incentives.<sup>130</sup> They also granted other favourable conditions to the supplying companies due to the need of attracting investors at a time of crisis. This was determined both by the increasing generation deficit, as well as the high political and regulatory risks for investment in Guatemala, including the internal conflict, the lack of a structured regulatory regime for energy and an annual escalation in capacity prices.<sup>131</sup> Compliance with PPA clauses is among the key reasons behind the steady increase of electricity prices throughout the first phase of reforms.

In 1996, the General Electricity Law broke down the monopoly in the energy sector, opening it to full private sector participation and unbundling its different activities (generation, transmission, distribution and retail). The Law also created a wholesale electricity market and established a new institutional and regulatory framework for the sector. The Ministerio de Energía y Minas (MEM) became the governing institution of the sector, the Comisión Nacional de Energía Eléctrica (CNEE), was established as the regulatory authority, and the Administrador del Mercado Mayorista (AMM) as the independent system operator.

The principles inspiring the law, which came into effect in 1998, were the promotion of competition, the establishment of rates based on real costs, the regulation of rates or tariffs to the “regulated market” under the supervision of CNEE and the establishment of quality standards for service. The Law also created a rural electrification trust of \$333 million, initially capitalized with \$101 million from the sale of INDE’s distribution businesses and \$51 million from the Government. The Fund’s role was to finance an aggressive rural electrification programme of subsidiary nature, conceptualized as a repayment concept of the “social debt.” The Fund was “armor-plated” to ensure that the resources would be used exclusively for its principal objective.

Foreign investment was invited in all segments (generation, transmission and distribution) and the Government adopted a policy to avoid new public investment in generation. Although the law itself did not require privatization of the state-owned utilities, it was widely perceived as a prelude to privatization and hence contested by the opposition. Consequently, the Government was unable to obtain the necessary majority in Congress (75 per cent of the votes) to grant the new regulatory commission (CNEE) full structural independence. Instead, CNEE was set up as a technical body of MEM, with functional and budgetary independence.<sup>132</sup> Without questioning the independence of CNEE, its structure is not in line with international best practice, according to which a regulator’s credibility is stronger when the institutional arrangements guarantee its full immunity from political pressure, from both the functional and structural point of view.

Eventually, the reform led to privatization and the entrance of foreign investors. In 1998, the majority stake of EEGSA was purchased by a consortium led by Iberdrola. INDE’s distribution business was split into two companies covering distinct regions, Distribuidora Eléctrica de Occidente (DEOCSA) and Distribuidora Eléctrica de Oriente (DEORSA), and privatized with a 50-year concession to another group led by Unión Fenosa. Also, a number of private plants, created under the PPA principle, entered the market. The first private non-PPA investments were La Esperanza, a 126 MW generation plant that entered into operation in 2001, followed by Duke’s Arizona plant, which began construction in January 2002.

<sup>130</sup> Projects based on renewable resources were offered additional incentives. Law 20 of 1986 provided 100 per cent deduction from income tax on investments in renewable energy, such as hydro.

<sup>131</sup> This represents a power plant’s fixed costs plus the payments to cover fuel

<sup>132</sup> Ley General de Electricidad, art. 4.

In 2000, the “Tarifa Social” mechanism was adopted establishing a subsidized price for a majority of small users (both residential and commercial). A bidding process for the supply contracts to provide electricity at affordable rates was adjudicated to INDE as the sole contender. Meanwhile, INDE also expanded the transmission system. Under several PPAs, INDE committed to build interconnection lines for renewable generators. Using the funds generated by privatization, transmission lines were expanded and some improvements to the system’s reliability were made.

As FDI began to trickle in, the Government decided to modernize and renegotiate the conditions guiding the PPA contracts in 2001. The goal was to remove some of what were considered abusive clauses. The annual escalation in the capacity price was removed; the capacity price itself was reduced, taking as a base the contract prices of 1998 and generators were deemed responsible before the AMM for penalties incurred. Two years later, the Government also decided to review the incentives extended to investment in renewable energy. Law 52 of 2003 established a new set of (lower) economic incentives to promote the use of renewable energy, which is still in place (chapter II, taxation section).

In 2004, CNEE also began a major revision of the regulations of the Electricity Act and the Wholesale Market. After a long process, both regulations were reformed in 2007 via Agreements 68-2007 and 69-2007. These lowered the minimum capacity threshold required for generators to participate in the wholesale market and granted CNEE greater enforcement powers. They also recognized the need for a Generation and Transmission Expansion Plan guaranteeing the role of private capital together with the planning role of the State (through the MEM).

Moreover, distributors were required to make an open tender for their electricity purchases. Automatic extensions of existing contracts were prohibited (due to concerns that this practice was leading to abuse) and the possibility to establish long-term contracts (15 years) between distributors and generators was introduced so as to strengthen the financial viability of the generation projects.

*a. Current state of the power system and the role of FDI*

As a result of the reform process, Guatemala’s electric power system is mostly owned by private investors, both foreign and domestic. However, a public entity, INDE, remains an important player, both in terms of transmission and generation.

In the last 10 years, FDI inflows totalling more than \$1.5 billion have entered the sector, in generation, distribution and, to a lesser extent, in transmission (box III.1 and chapter I for details on the privatization process).<sup>133</sup> The impact of such inflows on the electricity system has been important. Installed capacity has doubled since the market reform of 1996 while electricity generation has grown at an annual average of 6.6 per cent between 2000 and 2007. In 2008, the operational capacity increased by 122.8 MW with the commissioning of several generating units.<sup>134</sup> This solid growth is unmatched in Guatemala’s history and much of it is owed to FDI.

At the same time, however, heavy investments in thermal plants have led to a structural shift in the energy generation matrix (i.e. the contribution of the various primary energy resources used to produce electricity) away from hydropower as the dominant source of energy. Thermal power plants see faster returns to investment but the energy they generate is more expensive given the volatility of international prices for fossil fuels. As a result, the contribution of hydropower, still mostly in the hands of the state-owned INDE, decreased from 50 per cent in 1997 to 33 per cent in 2009, while the share of thermal

<sup>133</sup> The sale of the INDE and EEGSA distribution utilities generated \$621 million, which together with private investment in generation of more than 858 MW adds up to more than \$1500 million.

<sup>134</sup> These were: Arizona Vapor (4.535 MW), La Libertad (13.358 MW), Gecsa II (31.553 MW), Coenesa I (2.876 MW), Magdalena Block 5 (44.344 MW), Coenesa II (1.080 MW), St. Helena (0.700 MW) and Textiles Lake Block 3 (24.336 MW).

rose from 36 per cent to roughly 50 per cent. Biomass and geothermal, with 16 per cent and 2 per cent respectively, complete the country's energy generation matrix (figure III.1).

### Box III.1. Major foreign-owned energy companies in Guatemala

**Ashmore Energy International (AEI):** AEI was created in 2006 and incorporated in the Cayman Islands by the United Kingdom private equity fund Ashmore Investment Management Limited. It took over the former international operations of Enron for a reported \$2.1 billion in 2007. In Guatemala, AEI owns PQP, a 234 MW oil-fuelled thermal power plant that represents 10 per cent of the total installed electricity capacity. PQP supplies 110 MW of its capacity to EEGSA under a 20-year PPA that expires in 2013; the rest of its energy is sold to the WEM through its wholly-owned subsidiary Poli watt S.A. In addition, AEI is currently developing Jaguar Energy, a 300 MW coal-fuelled thermal power plant that entails an investment of \$800 million.

**Duke Energy:** Duke Energy is the third largest electric power holding company in the United States of America. The company currently operates three oil-fuelled thermal power plants in Guatemala, equivalent to 12 per cent of the country's total installed capacity: Arizona (160 MW), Las Palmas I (90 MW) and La Laguna (35 MW). Duke is building an additional 83 MW coal-fuelled power plant, Las Palmas II, which should come into operation in 2010. The firm has also announced the construction of a 21 MW hydropower plant in Alta Verapaz for an estimated amount of \$45 million.

**ENEL:** The Italian energy company ENEL is present in Guatemala with four hydro-electric power stations in operation (San Isidro, Matanzas, Canada and Montecristo) with an aggregate installed capacity of 76 MW. It has invested \$150 million for the construction and operation of these four power stations. A fifth 85 MW station expected to cost \$260 million, "Palo Viejo", is under construction in Quiché and expected to be operational by mid-2011.

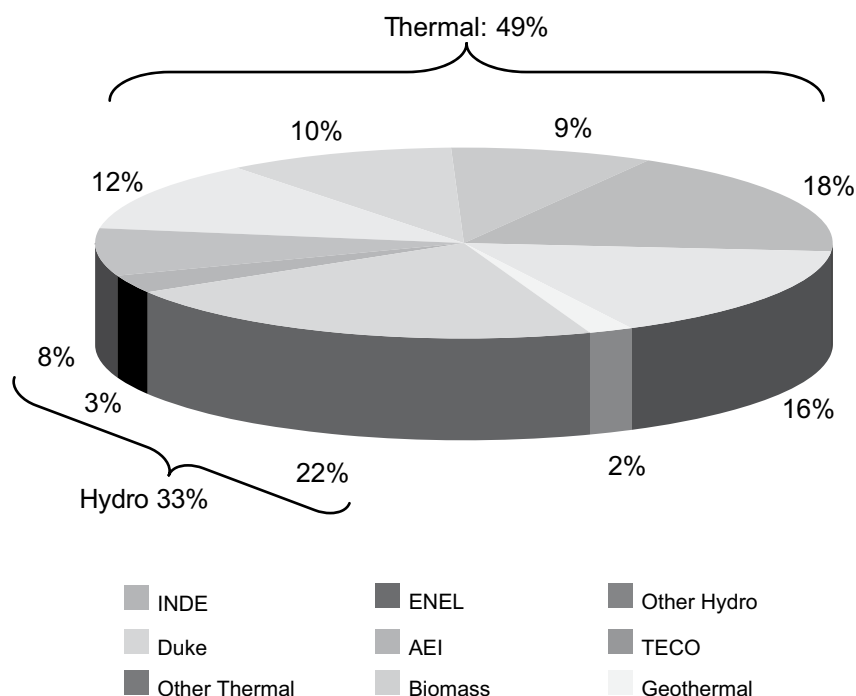
**EPM:** At the end of 2010, the Colombian public service provider EPM agreed to acquire Guatemalan utility providers from three companies for \$635 million. EPM will acquire Distribución Eléctrica Centroamericana II, the major shareholder in Empresa Eléctrica de Guatemala (EEGSA) and other utility firms in the Central American nation. With an estimated 880'000 customers (37 per cent market share) in 2008, EEGSA is the single largest distribution company in the country.

**Iberdrola:** The Spanish company first entered Guatemala when it led a consortium that acquired 80 per cent of the distribution company EEGSA in 1998 for a reported \$520 million. Recently, Iberdrola sold its participation in EEGSA to the Colombian consortium EPM. Iberdrola also owns a small transmission company: TRELEC.

**Unión Fenosa:** Unión Fenosa, also from Spain, entered Guatemala's electricity distribution market after buying an 80 per cent majority stake in two previously state-owned companies - DEORSA and DEOCSA - in 1999 for an initial investment of \$101 million. DEORSA, serving the eastern region, has 489 thousand clients and DEOCSA, serving the west, has 825 thousand according to a 2008 estimate. Together they have a 56 per cent market share. Unión Fenosa also owns RECSA, a small transmission company.

INDE is the single largest generator and supplies most of the hydropower energy, about 497 MW or 22 per cent of total installed capacity, and owns a 76 MW thermal plant in Escuintla as well (bringing total share to 24 per cent). The remaining 1'792 MW, or 76 per cent of the country's installed capacity, is in the hands of thirty private companies and encompasses all types of energy sources. The leading three private generation companies, all foreign-owned, control roughly 31 per cent of total installed capacity.

**Figure III.1. Guatemala: composition of installed capacity, June 2009**  
(In percentage)



Source: AMM.

Note: INDE's thermal contribution of 76 MW is not included.

The public ETCEE, a subsidiary of INDE, is the main transmission company. In addition, there are three smaller private transmission companies, all foreign investors: Iberdrola's subsidiary TRELEC, Unión Fenosa's RECSA and Duke Energy. In January 2010, a consortium composed of Colombian companies, EEB and EDM, won the bid organized by CNEE to extend and operate 853 km of transmission lines, a project that is estimated to cost between \$373 and \$420 million.

As for the distribution system, local municipalities retain control over 17 small distribution companies and INDE over the distribution network in some rural areas. The remaining network, as mentioned, is dominated by FDI, with Unión Fenosa serving the eastern and western regions of the country, and Iberdrola serving Guatemala's central region, the most populated area which includes the capital city. The impact of FDI in distribution was also noticeable. Public support and investment injection greatly improved, electrification coverage, which grew from 64 per cent in 1998 to 83.5 per cent in 2008. The waiting time to get an electricity connection also declined significantly.

Despite the advances in electricity coverage and the growth in installed capacity, electricity demand is growing faster than supply. In the 2002–2006 period, the growth rate for energy demand averaged roughly 26 per cent while the supply offered grew by only 20 per cent. Given Guatemala's high demographic growth rate at 2.1 per cent,<sup>135</sup> the electricity sector will have to add somewhere between 2'500 MW to 2'770 MW in installed capacity by 2022 to meet the expected increase in demand and this will require an investment of \$3'200 to \$3'500 (MEM and CNEE 2007). The medium-growth scenario of the 2008–2022 indicative generation expansion plan estimates that an annual average of 190 MW will need to be installed during the 15-year period, and that approximately 1'500 MW will need to be added in the first five years alone to satisfy demand.

<sup>135</sup> CIA World Factbook estimate for 2009. Guatemala has the second highest population growth rate in Latin America only behind Paraguay (2.4).

Meeting growing electricity demand also presents a challenge given the fluctuations of hydro and biomass generation. Effectively, generation capacity varies seasonally and experiences a decline during the dry season for hydro, and outside the harvest of the sugarcane period (the so-called “zafra” period<sup>136</sup>) for biomass. In 2008, for example, operational installed capacity was estimated at 2’030 MW during zafra and 1’799 MW outside of it. In that same year, the maximum demand registered was 1’430 MW and occurred on 13 May, during the critical period for generation: in the dry season when the zafra had ended. As such, the “cold reserve” margin (i.e. available installed and operational capacity that can be put to use when/if needed) was as low as 21 per cent on that day. Although the annual average margin is closer to 30 per cent, given the inefficiencies of the transmission system, it is seen as a tight margin which could put at risk the country’s electricity supply in the future.

*b. Structure of the electricity sector in 2009*

The current legal framework governing the electricity sector is defined by the General Electricity Law of 1996 (Decree 93-96) and its subsequent reforms as discussed above. This law created new regulatory institutions and defined their roles and responsibilities (table III.1).

Based on this legal and institutional framework, the electricity sector is a mixed system with a large private participation, a market structure providing for no legal barriers to entry into generation, transmission and supply/sales segments. Also, there is open access to the transmission and distribution grids under regulated prices.

**Table III.1. Institutional framework of the energy sector in Guatemala**

Entity	Role	Responsibilities
<b>MEM</b> <i>Ministerio de Energía y Minas</i>	Governing institution	Overall legal oversight. Issues authorization to generation, transmission and distribution companies. Has statutory responsibility for national energy plans (expansion of generation and transmission).
<b>CNEE</b> <i>Comisión Nacional de Energía Eléctrica</i>	Regulatory authority	Receives and processes requests for authorizations. Supervises compliance with the law and defines adjustments in regulated distribution and transmission tariffs. Monitors service quality and issues norms for these. It is delegated to temporarily perform planning functions.
<b>AMM</b> <i>Administrador del Mercado Mayorista</i>	Independent market operator	Administers the wholesale market and acts as system operator for transmission, distribution and international connections. Determines the hourly spot market prices and is responsible for the reliability and availability of energy provisions.

Source: UNCTAD.

Power generation can be traded in national and international markets. At the national level, the different components forming the wholesale electricity market (WEM) include: 1) a spot market based on a short-term marginal cost dispatch (described below), and 2) a contract market in which agents and important users freely agree on the conditions of their contracts, including amounts of electricity to be consumed, price, capacity adjustment and ancillary services.

Energy and capacity are traded as distinct products in the spot and contract markets (table III.2). In the spot market, hourly energy prices are determined by the least-cost ranking of available resources. These prices are established on the basis of: incremental cost information submitted by thermal plant operators; value of water bids submitted by hydro plant operators; and demand-side schedules allowing disconnection of load at certain spot market prices.<sup>137</sup> Thus, every generator called to operate by the dispatcher (AMM) is remunerated at the price of the most expensive kWh.

<sup>136</sup> During the zafra period, bagasse is available for cogeneration.

<sup>137</sup> This means that AMM covers the daily load with energy offers coming from the generators ranked according to increasing costs. Consequently, the least cost plants are dispatched first. The last kWh of the actual demand will be supplied by the most expensive plant that in the merit order matches the last cumulated kWh of the actual demand.

Meanwhile, the contract market offers a variety of standard agreements with respect to bundling of energy and capacity, price certainty and other characteristics. Large consumers (users with a power demand exceeding 100 kW) can freely and directly contract from generators or market operators, or buy from the spot market. About 800 large consumers, representing only 0.3 per cent of the consumer base, but responsible for around 40 per cent of total consumption have opted for the direct contract option.

At the retail level, the market is substantially regulated and only a small part of the users are eligible to contract their electricity needs freely. All distribution companies must back up their supply to regulated customers through long-term contracts with generators. Rates are regulated under a price cap system, whereby the non-competitive cost elements (such as the use of wires and transmission equipment) are set every five years according to efficiency standards and adjusted periodically for inflation and other factors.<sup>138</sup>

**Table III.2. The electricity market structure in Guatemala**

	Wholesale market	Retail market
<b>Composition</b>	The spot and contract markets.	All normal final consumers supplied by the distribution companies connected to the National Interconnected System. <sup>139</sup>
<b>Participants</b>		
<i>Supply</i>	Generators with a minimum power of 5 MW (31 agents) and transmission companies with a minimum connected firm power of 10 MW (1 public and 3 private).	20 operating distribution companies.
<i>Demand</i>	Distributors serving a minimum of 15'000 users (3 private companies and 17 public municipal enterprises), trading companies with a power of at least 2 MW (21 agents) and large users with a demand over 100 kW (about 800 users).	Consumers whose demand does not exceed 100kW. This includes some 2.3 million households, out of which 1.8 million benefit from a subsidized rate.
<b>Price setting</b>	In the spot market, based on a short-term (hourly) marginal cost dispatch. In the contract market, freely negotiated by both parties.	There is a cap price or maximum rate distribution companies can charge consumers which are adjusted every three months. For subsidized rates, the <i>Tarifa Social</i> is also periodically adjusted while the two-tier <i>Tarifa Solidaria</i> is fixed.
<b>Administrator/Regulator</b>	AMM	CNEE

Source: UNCTAD.

There are two subsidized tariff rates in the regulated retail market: the “tarifa social” and the “tarifa solidaria”. The tarifa social is adjusted periodically and applies to consumers whose monthly consumption is between 101 – 300 kW and corresponded to \$0.17 per kilowatt-hour in 2009. The tarifa solidaria, introduced in 2008, is two-tiered and has a fixed rate: \$0.09 per kilowatt-hour for consumers whose monthly consumption is between 51 – 100 KW and \$0.06 between 0 – 50 kW.

### c. Government objectives and development plans

The policy goals pursued by the Government of Guatemala are expressed in the MEM’s document “Política Energética y Minera” of April 2009 (MEM, 2009). The overall objective is to ensure access to a sufficient and economically dependable supply of energy to the entire population. Specific targets associated with this objective include the reduction of oil-dependency, an increased use of renewable and hydro-power energy as well as improved public participation in the decision process regarding the localization of power plants.

<sup>138</sup> The CNEE sets rates for transmission services and for regulated medium and small consumers according to the parameters established by the Electricity Law and its related regulations. Energy and capacity prices are passed through from the contracts to the final consumers and adjusted every three months according to the terms of the contracts.

<sup>139</sup> The transportation system is made up by the main system and the secondary system, the first of which is shared by the generators and by the interconnections with other countries, basically operating at three voltage levels: 230, 138 and 69 kW. The secondary system is the means by which a generator interconnects with the main network. The two systems form the National Interconnected System.

Continuing on the actions of the previous administration (MEM, 2007), the current Government has identified a number of critical issues that need to be addressed in order to achieve the overall objective. These include: 1) the unfavourable composition of the energy matrix (e.g. reliance on expensive thermal energy) that undermines the rational use of national energy resources; 2) the inability of the system to meet the growing demand which threatens an already low reserve security margin exacerbated by a high population growth rate; and 3) the necessity to reform the transmission system that is prone to losses and unable to incorporate renewable sources of energy.

In addition to undertaking national measures to address the country's electricity problems, the Government of Guatemala is also a key participant in the Sistema de Interconexión Eléctrica para América Central (SIEPAC). This project aims at interconnecting the power grids of six participating countries of Central America and at fostering the creation of a single regional market (box III.2). Furthermore, the interconnection with Mexico, inaugurated in October 2009, began its first phase of commercial operation in April 2010.

### Box III.2. The SIEPAC project

The SIEPAC project refers to interconnection of the power grids of six Central America nations. The project has two main objectives:

1. To support the formation and progressive consolidation of a Regional Electrical Market (MER) through the creation and establishment of appropriate legal, institutional and technical entities. This should facilitate the participation of the private sector in the development of electricity generation;
2. To establish the interconnection infrastructure (transmission lines, equipment of compensation and substations) to allow interchanges of electricity between participants of the MER.

The project entails the construction of approximately 1'800 kilometers (km) of transmission lines at 230 kV, connecting 37 million consumers in Panama, Costa Rica, Honduras, Nicaragua, El Salvador, and Guatemala. SIEPAC would cost about \$320 million, excluding the interconnections with Mexico (\$40 million), Belize (\$30 million) and Panama (\$ 200 million). The financing is currently provided by the Inter-American Development Bank (IADB). The institutional component is under a regional entity responsible for the integration, coordination and cooperation of the electricity sector called Consejo de Electrificación de América Central (CEAC). The "Empresa Proprietaria de la Red - EPR", participated by the electricity companies of each Central American countries (INDE for Guatemala) is responsible for the construction of the network.

The successful implementation of such project together with reinforcing the national systems of transmission should promote a reliable and safe energy transmission capacity of around 300 MW among the countries involved.

Source: ERPSIEPAC.

Official documents do not refer to an explicit role for FDI in the implementation of the energy plans. However, recent history has showed that foreign investment could indeed contribute to significant improvements in the electricity sector. In the last years, Guatemala has embarked upon a large effort to promote foreign investments. A number of road shows and promotional activities were organized by CNEE in Europe, North and South America, in coordination with the national investment promotion agency and Guatemala's diplomatic outposts. These have born fruits, and CNEE estimates new FDI in generation and transmission to be worth more than \$1.1 billion.



The achievement of the ambitious objectives set by the Government would require the continued use of foreign capital. The financial situation of the country and that of INDE make it challenging to undertake such commitments and the domestic private sector, despite its interest, does not possess the required know-how nor the capital to play a major role. As will be stressed in the following sections, FDI could therefore play a key role in achieving the objectives of the Government. In this respect, while there are some defined policy objectives for the sector, as well as specific plans for the expansion of generation and transmission, a comprehensive energy policy is lacking. There is no national strategy that can serve as an integrated analysis framework for the sector (see section A.3).

## 2. Sector analysis

Taking into consideration the objectives identified by the Government, this section analyzes the key underlying issues in the electricity sector that need to be addressed in order to effectively support Guatemala's development. These include: a) market efficiency and price of electricity; b) energy security, renewable energies and infrastructure modernization; c) institutional arrangements; and d) FDI attraction potential.

### a. Market efficiency and price of electricity

Guatemala's electricity market is deemed inefficient chiefly by the unusually high prices that threaten the country's competitiveness across all sectors. Customer prices that users not covered by the subsidized rates are subject to pay are sometimes more than double or even triple than those in neighbouring countries with a comparable electricity potential. In fact, final consumers in the regulated market pay the highest prices for electricity in the region (table III.3). Some investors interviewed also pointed out that the cost of electricity to businesses were the highest in Latin America.<sup>140</sup>

**Table III.3. Comparative electricity prices in Central America, at 30 June 2010**  
(Dollar cents per kilowatt hour)

	Costa Rica (ICE)	El Salvador (CAESS)	Guatemala (EGGSA)	Honduras (ENEE)	Nicaragua (DN y DS)	Panama (Elektra)
<b>Residential</b>						
50 kWh	11.18	22.68	<b>26.18</b>	7.90	12.59	18.49
99 kWh	11.18	21.93	<b>25.13</b>	7.64	15.27	18.42
200 kWh	11.18	20.61	<b>24.59</b>	11.00	19.15	18.39
751 kWh	22.64	20.74	<b>24.20</b>	15.80	25.75	19.36
<b>Commercial</b>						
1'000 kWh	19.26	19.15	<b>24.16</b>	20.45	23.34	19.86
15'000 kWh, 41 kW	16.40	16.17	<b>28.92</b>	20.83	22.69	21.24
50'000 kWh, 137 kW	16.41	15.69	<b>22.40</b>	20.85	22.70	16.98
<b>Industrial</b>						
15'000 kWh, 41 kW	16.40	16.17	<b>27.41</b>	20.86	20.79	21.24
50'000 kWh, 137 kW	16.41	16.66	<b>21.48</b>	20.85	20.80	16.98
100'000 kWh, 274 kW	16.41	16.65	<b>21.39</b>	14.82	20.85	16.98
930'000 kWh, 2500 kW	12.85	16.62	<b>21.27</b>	14.43	18.60	15.67
1'488'000 kWh, 4000 kW	12.85	16.62	<b>21.27</b>	14.43	18.60	15.67
<b>Exchange rate</b>	581.45	8.79	<b>8.08</b>	19.03	21.36	1.00

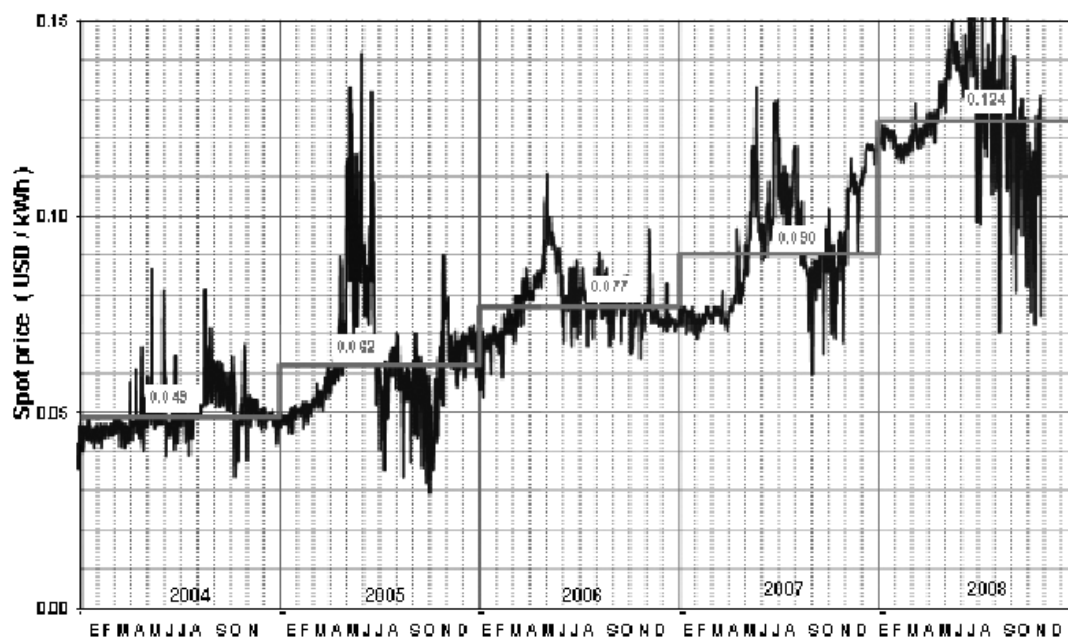
Source: ECLAC (2010).

Notes: For all countries, the values do not include taxes, fees or direct subsidies. Whenever the power is specified, a 50 per cent load factor was used. For Honduras, variations to the price of fuel are taken into account.

<sup>140</sup> According to an investor, the price of electricity in dollars per kilo-watt hour in Guatemala was of \$0.21 while in Mexico it was \$0.13, Colombia \$0.12, Brazil \$0.10, Argentina \$0.08, Peru \$0.06 and the Bolivarian Republic of Venezuela, the "best practice" example in the region, was \$0.02.

Furthermore, the annual average price in the spot market, taking into account both the capacity and energy components, has experienced a sustained growth from \$0.03 per kWh in 2001 to the current level of \$0.12 per kWh in 2008. This represents an average growth rate of 20 per cent per year (figure III.2), which is unaffordable for any industry to keep up with and is threatening the viability of many sectors, in particular those that already face stiff competition (e.g. textiles).

**Figure III.2. Spot market price evolution in Guatemala, 2004 - 2008**  
(Dollars per kilowatt hour)

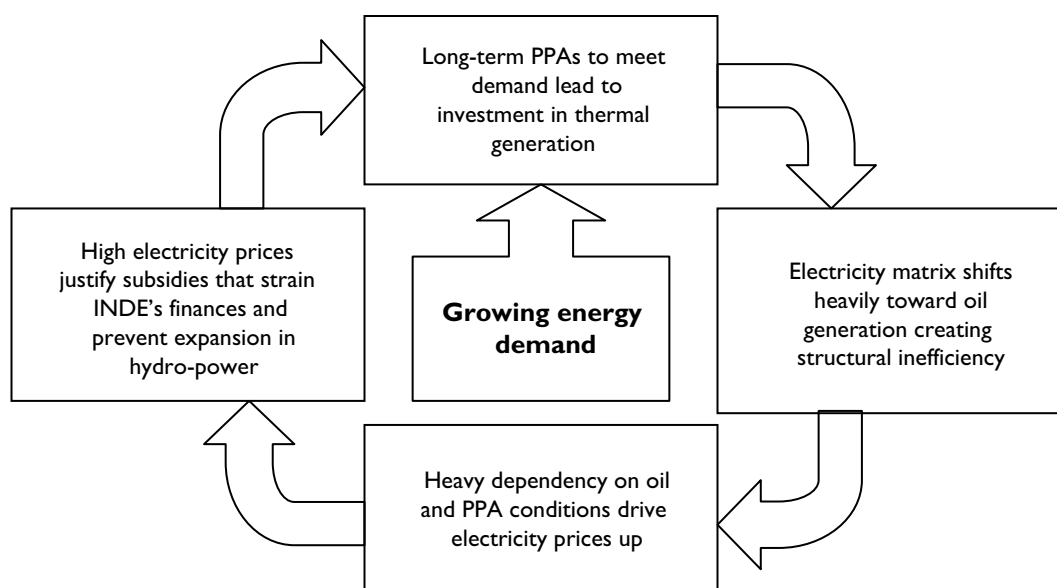


Source: Presentation by Eng. Ascencio Lara during *II Feria Energética – Guatemala* (3 December 2008).

The factors driving prices up derive mainly from the current energy matrix along with some characteristics of the regulatory model. At present, roughly 47 per cent of electricity is produced by expensive oil and only 36 per cent by cheaper hydro power. This unfavourable balance in the matrix leads to high prices in the wholesale market for generation, which represents an important determinant of the final tariff. Losses and inefficiencies in the network also add to the final price.<sup>141</sup>

PPAs account for roughly 25 per cent of total generation and the conditions negotiated in the PPAs prior to 2001 have also contributed to the high electricity prices. As mentioned, at the early stage of the reform, when the urgent need for a fast injection of new generating capacity required moving away from traditional hydro generation in favour of fuel oil generation, private investment was mobilized through long-term PPAs with very good conditions granted to the sellers, which put a strain on INDE's finances. Figure III.3 summarizes the vicious circle that characterized the early stage of the electricity sector's reform, whereby a high electricity demand led to a shift in the energy matrix in favour of oil. These expensive PPAs must be honoured until their expiring dates, the latest of which is expected in 2014, hence their impact on prices is bound to phase out.

<sup>141</sup> The composition of costs incurred per kilowatt hour are as follows: generation 71 per cent, distribution 17 per cent, transmission 5 per cent and losses 7 per cent. This is according to information provided by Sergio Velásquez from the CNEE during the ARIAE Meeting – Cuzco Peru (May 2009).

**Figure III.3. Guatemala's electricity sector inefficient vicious circle**

Source: UNCTAD.

Finally, INDE subsidizes electricity consumption through two different plans: the “tarifa social”, introduced in 2000 and the “tarifa solidaria” introduced in 2008. While there is a social argument to support the electricity consumption of the poorest households, there is evidence that despite the recent introduction of progressive segmentation in the tariff regimes (with the introduction of the tarifa solidaria), subsidized rates in Guatemala are inefficient at targeting those who really need them. The generous subsidy scheme, a financial burden directly carried by INDE<sup>142</sup> and indirectly affecting non-subsidized users, is creating not only distortions in the market but also jeopardizing the financial viability of the public entity.

Prior to 2001, the subsidized rate covered consumers whose monthly consumption was below 650 kWh, corresponding to an estimated 98 per cent of consumers. By 2004, when the threshold was brought down to 300 kWh, close to 87 per cent of consumers continued to qualify for the subsidy. The fact that reducing the consumption limit by half reduced by a little more than 10 per cent the number of users indicates that the band between 300-600 kWh per month is not really representative of the energy consumption of residential users. Furthermore, considering that the poverty threshold corresponds to an electricity consumption of about 24 to 53 kWh per month (SEGEPLAN) shows that the limit defined for the application of the social tariff is quite high and most people receiving the subsidy may indeed not be part of the poorest population. There have also been reports of abuse on behalf of consumers.<sup>143</sup>

Various negative repercussions on the market result from the distorting subsidy scheme. First, since INDE is the only generator that can provide electricity at subsidized prices, it is forced to sell its cheap electricity to the regulated distributors. This also implies that since thermal plants which produce more expensive energy are left as the main suppliers to the wholesale market, prices are artificially inflated and INDE cannot act as a competitive force in the market.

Second, given the seasonal reduction of operable installed capacity, INDE is obliged, during the dry season, to purchase the energy needed for the subsidy scheme at spot market prices and resell it at a lower

<sup>142</sup> Due to the low generation costs required by this portion of the tariffs, INDE remains the only company able to match the distributors bid conditions for providing the service. The remaining generators are kept out, as they produce energy mainly with thermoelectric plants with generation costs over the requirements of the social tariff.

<sup>143</sup> It has been reported that households and small businesses split their consumption into several meters to qualify for the social tariff in response to this artificial distortion according to the survey for the World Bank Investment Climate Assessment.

rate (the social tariff). This significantly affects INDE's capability to undertake critical investments for the maintenance of the system or for its expansion. According to MEM, the burden of the subsidy scheme on INDE can be estimated at \$50 million per year, without considering the cost of selling its energy at a price lower than the market price (opportunity cost).

Finally, since most consumers, including SMEs, qualify for the subsidized rate, and large users can directly negotiate their energy supply, no supplier competition in the form of distribution trading companies has emerged at the retail level, although the legislation does not prevent it.

*b. Energy security, renewable energies and infrastructure modernization*

The second critical issue to address is to meet the growing energy demand. As described, between 2002 and 2006 the growth in energy demand outstripped supply and this trend is expected to worsen considering Guatemala's population growth. Consequently, the annual energy surplus destined for exports has been on the decline. This has tightened the security margin of the system and has raised concerns about the future security of supply.

Since 2003, the frequency of power outages has increased. For example, the average number of outages per month experienced by businesses has shifted from 1.5 times a month in 2003 to 5 times a month in 2007. While the average duration of a single outage declined, from 4.6 hours in 2003 to 3 hours in 2007, the incidence of outages resulted in increased total hours of outages. Furthermore, while the share of Guatemalan firms subjected to power outages has dropped, the number of power cuts for those bearing outages has increased (World Bank, 2008).

These outages and concerns about security of supply are in large part due to the poor state of the electricity infrastructure. At the distribution level, the electricity network is facing serious technical and management problems with energy losses representing almost 14 per cent of the total energy production. Best practice around the world show losses around 7 per cent. This is not negligible as reducing losses to 7 per cent of the total energy production would represent in the case of Guatemala a saving of about 700 GWh per year, in which case, about 100 MW of additional capacity would not be needed.

A long period of underinvestment in the transmission system has resulted in a fragile and ineffective grid, and in uneven geographic coverage.<sup>144</sup> The general blackout of November 2007, for instance, was not caused by a generation failure but resulted from the breakdown of a transmission tower. The investment attractiveness of the business model for transmission infrastructure declined over time, as the remuneration of a new investment through a specific and proper fee had not been foreseen in the regulation. The operational tariffs were not sufficient to justify the related investments neither from a private investor nor from a public body like INDE. This situation has changed recently, however, as new investment in transmission is foreseen, with the award to build more than 800 km of high voltage transmission lines (230 KV) and more than 20 substations to a Colombian consortium, which are expected to double the transmission capacity of the country by 2013.

Deficiencies in infrastructure negatively affect access to electricity and its consumption, particularly in rural and isolated areas. Although an estimated 85 per cent of the population (2.3 million households) has access to electricity, distribution shows a marked differentiation between urban and rural settings. As of 2009, INDE identified over 3'400 communities (some 700'000 people) lacking electric power because of their faraway location. Although the coverage (electrification index) is at par with regional standards, consumption per capita confirms low penetration of electricity in the country (table III.4). Encouragingly,

<sup>144</sup> Characterized by congestion in the southern part of the country, where there is a concentration of electricity capacity and loads and no coverage in the northern region, which is rich of unexploited resources.

Guatemala has recently received a \$55 million loan from the Inter-American Development Bank to finance a rural electrification programme to be implemented by INDE.

**Table III.4. Electrification index and electricity consumption per capita, 2008**  
(Percentages and annual kilowatt-hour per capita)

Country	Electrification index	Electricity consumption per capita
Costa Rica	98.8	1'861
El Salvador	85.8	836
<b>Guatemala</b>	<b>85</b>	<b>558</b>
Honduras	77	700
Nicaragua	64.5	445
Panama	89	1'594
Latin America	...	1'838

Source: ECLAC and MEM.

The poor condition of the electricity infrastructure jeopardizes the security of supply and has driven many businesses to rely on self-generation. A World Bank inquiry found that more firms in Guatemala complained about access to reliable electricity supply in 2007 than they did in 2003; in the region, Guatemala is only performing better than Nicaragua (World Bank, 2008). Firms that own or share a generator depend on it for close to 30 per cent of their energy needs.

Recognizing these issues, MEM has defined a set of actions for continuous long-term planning and monitoring in line with free market principles. The new responsibilities allocated to MEM and CNEE for these planning actions are defined in several government agreements,<sup>145</sup> in particular with respect to the expansion of generation and transmission (MEM and CNEE 2007; MEM and CNEE 2008). The generation expansion plan envisages adding at least 2'500 MW of capacity during the 15-year planning period – from 2008 to 2022 – to meet growing demand expected to be between 4 and 6 per cent per annum. As supply increases, the plan expects that the average electricity price should decline from \$0.12 per kWh to \$0.08 per kWh while the security margin should improve.

Along with the aforementioned generation expansion plan, a transmission expansion plan was drafted by CNEE. It foresees a strong improvement of the main connectivity axes,<sup>146</sup> a more modern, effective and efficient topological concept of the grid, and finally a system which respects the international standard in terms of reliability (the N-1 failure criteria). This means imposing that the grid keeps continuing in normal operation including in case of failure of one grid element (e.g. a transformer, line or generator). The plan should be completed by 2018 and foresees adding about 1'400 km of transmission lines as well as expanding and/or reinforcing 40 substations for a total cost estimated at \$500 million.

The modernization of the transmission grid is necessary to diversify the electricity matrix and foster the development of renewable energy. The exploitation of high-potential alternative energy sources, such as wind and solar, is strongly limited by the capacity of the grid to integrate these non-programmable sources. Targeted investments are needed to develop a so-called “smart grid” able to integrate renewable energies into the transmission system (box III.3).

<sup>145</sup> These agreements are 68-2007 and 69-2007, as well as CNEE-PEG 2008-2022 and CNEE- PET 2008-2018 for the indicative expansion plans for generation and transmission, respectively.

<sup>146</sup> These are Mexico-Guatemala-El Salvador, Guatemala-Honduras and domestic North-Centre-South and Pacific-Centre-Atlantic connections.

### Box III.3. Smart grid modernization

The “smart grid” concept refers to the modernization in both transmission and distribution to increase connectivity, automation and coordination between suppliers, consumers and networks. Upgrading to the latest technology brings with it multiple benefits, including a more efficient use of energy, an increased reliance on cleaner renewable sources of energy as well as the decentralization of the energy supply.

New technologies that offer real-time management of electricity distribution can improve consumption efficiency. The introduction of “smart meters”, for example, allows suppliers to charge variable hourly rates that reflect the cost of generating electricity during peak and off-peak periods. Consumers informed of these differentiations in hourly rates would have an incentive to consume less during peak hours, thus reducing their cost and the stress on the system to meet demand.

Smart grids are also able to incorporate renewable energy sources that are intermittent in nature, meaning they depend on non-programmable natural phenomena (e.g. the sun or wind) to generate power. Their improved storage and ability to reduce electrical demand by “load shedding” in the event of an un-programmed interruption are necessary to integrate these sources of energy.

Traditional distribution networks are uni-directional: networks supply bulk power to end-users. Advancements in technology, however, are changing this paradigm to a bi-directional grid. This means that in the future businesses and households can begin generating energy on their own and could be able to sell their surplus back to the utility companies. In a country where self-generation is already a widespread phenomenon among several businesses, this smart grid feature could become quite successful in stimulating competition to increase supply and reduce energy prices.

Source: UNCTAD.

#### c. *Institutional arrangements*

The successful implementation of any energy policy depends on coordinated efforts of the institutions with responsibility for the sector. In Guatemala, MEM, the regulators and the Ministry of Environment often present insufficient capacity and budget to adequately play their role.

A 2007 amendment to the Electricity Regulation allocated the responsibility for the long-term planning of the country’s energy sector to MEM. However, the relevant department within the Ministry has not yet been set up and the related functions have been, until now, executed by CNEE. Meanwhile, the plans for the expansion of generation and transmission have been prepared by CNEE. While the plans integrate the required elements to effectively upgrade the electricity system, they do not address social aspects or evaluate the opposition to medium and large hydroelectric projects by many indigenous communities. These important aspects, which risk undermining the success of the proposed plans, could have been better addressed with strengthened coordination among ministries and government agencies.

Nowadays, independent regulators are expected to perform many different functions. They have to ensure that the regulation in place is credible, so as to support the development and functioning of a competitive energy market. This includes promoting competition, protecting consumers’ rights, correcting market failures and fostering government effectiveness, and handling public relations. They also have to be accountable for the manner in which they conduct their activities. Thanks to good human capacities and notwithstanding limited resources, CNEE has made a strong effort to comply with all these activities in

a proactive way. To date, not a single payment to the investors in the electricity sector has been missed (generators, transmission and distribution companies), reflecting the stability of the regulatory framework and the respect of contracts.

However, some investors expressed concerns to UNCTAD during the fact-finding mission regarding the independence of the regulatory authority, claiming that there is an insufficient balance of power between the regulator (CNEE) and the market administrator (AMM). Their argument is that the AMM is weak because it can be audited by CNEE, and INDE (dependent on MEM) is a member of its board of administration. They also questioned the independence of CNEE based on a recent dispute between EEGSA and CNEE for the determination of the value added in distribution of electricity (VAD). This dispute has led to a case of international arbitration before ICSID (chapter II).

As mentioned, when the Electricity Law was approved, the incumbent Government did not reach the necessary majority to give the new regulatory commission full structural independence and episodes of interference occurred in early years of the Commission's life. Since then, however, no episodes of direct political interference on the regulator have been reported. Nonetheless, it is advisable to strengthen the institutional insulation of the regulator from the executive, in line with best international practice. This would foster investors' trust on the equanimity of the balance between public interest and private interests. It would also protect the regulator from further claims of political dependence.

As discussed in chapter II, MARN is responsible for the elaboration of environmental policies and for their implementation. In the energy sector, this includes defining quantitative targets for a functioning climate change policy, setting standard limits for environmental pollution agents, performing environmental impact assessments for all proposed projects in the energy field, and monitoring the related environmental impact on the different existing sites. As seen in chapter II, its budget and staff hardly allow MARN to fully perform those functions.

Finally, INDE is a key player in the sector whose role as a generator and transmitter is threatened by its institutional weakness. Its participation in the market is essential to keep the regulated prices low and to assure the functioning of the main grid. Yet, as discussed above, its potential as a competitor and investor in the market is seriously jeopardized by its financial fragility. Not only does INDE bear the burden of financing the subsidy scheme but, under the current juridical profile, it has no freedom to utilize its asset base to get financing in national and international market without congress approval and cannot establish an industrial development plan for growth. Under all aspects, it is more a state agency than a corporation, and lacks a proper corporate strategy.

#### *d. FDI attraction potential*

In Guatemala, roughly 46 per cent of the total installed capacity is oil-based. The government plans to diversify away from oil by relying more on coal, a cleaner and cheaper short-term alternative, as well as renewable energy sources (table III.5). Currently, only 15 per cent of hydro and 5 per cent of geothermal potential is being exploited. MEM has estimated the country's economically viable and unexploited renewable potential at around 7'000 MW – three times its actual national power capacity – and composed of hydropower, geothermal, and wind farm.

In addition, biomass potential has not yet been assessed but it appears to be important. The current installed capacity in biomass energy is of only 370 MW. However, Guatemala has the largest sugar cane mills and plantations in Central America. Special measures were taken to encourage the development of co-generation by favouring long-term electric power purchases within a dual generation scheme (using both bagasse and oil derivatives) that also permitted production outside of the sugar cane season.

**Table III.5. Guatemala's energy matrix**  
(Percentage)

Energy sources	2008	2012	2022
Hydro	37.6	47.5	58
Thermal oil	46.1	4.3	0.6
Thermal coal and biomass	13.2	46.1	37.2
Geothermal	3	2.1	4.2

Source: MEM "Plan de Expansión Indicativo del Sistema de Generación 2008 – 2022" (MEM and CNEE 2007).

MEM's indicative expansion plans for generation and transmission (developed through CNEE) aim at adding 100 MW of installed capacity per year, in addition to replacing 50 MW of existing generating capacity annually. The expansion in generation envisaged by the Government would require a total investment of somewhere between \$3 to \$3.5 billion (considering that the addition of 1'000 to 1'500 MW of new power plants would come at an average cost of \$2'000 per kilowatt installed). Local private investors, sugarcane co-generators and small hydro developers could likely cover \$0.5 billion but the rest would have to come from INDE and foreign capital.<sup>147</sup> Established foreign investors agree that Guatemala has good potential in renewables, and call on the Government to address the issues that are affecting new investment decisions, including the lack of a national plan for renewable energies and need to improve mechanisms for consultations with the local communities (box III.4).

For its part, expansion of the transmission system will call for additional investment. It is encouraging in this regard that fresh investment was announced by the Colombian consortium that won the bidding early in 2010, but other opportunities could emerge for FDI if initiatives to strengthen the distribution system or to promote renewable energy are implemented by the Government (see next section). Thus, FDI would not only provide the necessary capital, it would also become an important partner in leading innovation in the use of new technologies (e.g. in developing a smart grid).

The stability of the regulatory framework, the expected growth in electricity demand, high electricity prices, and the strong presence of existing foreign investors in the electricity sector are all factors pointing to a high potential for FDI attraction. The regional dimension of the electricity market accessible from Guatemala could also prove an important FDI attraction asset. As mentioned, plans for electric power transmission infrastructures will allow for the interconnection between Mexico and Central American countries, making the development of the international electricity trade business in the whole area possible and giving investors access to the entire Central American market (SIEPAC project). In this respect, the bilateral interconnection with Mexico and its recent opening of commercial operations is promising.

The development of Guatemala's electricity sector in the last fifteen years showed that the conditions to benefit from FDI exist and foreign investors in the sector are overall satisfied. The perception coming from all companies interviewed (investors long established in the country and new entrants) is that the market is functioning quite well and a certain degree of stability has prevailed until now. Investors expressed their trust in the fact that Guatemala is a good place to invest both as single market and/or regional hub. They highlighted several Guatemalan-specific conditions favourable for their investments (table III.6).

However, a number of concerns expressed by investors point to regulatory and perception issues that should be addressed and not underestimated. These could prove crucial in determining the success of future investment attraction efforts as well as the retention of existing investors. The main such issues are the investors' widespread perceptions that the government authorities are not doing enough to mediate conflicts arising from opposition from local communities, and the concerns regarding the balance of powers between the public authorities.

<sup>147</sup> At the moment, there are various generation projects in progress that will add 950 MW by 2021 and of which 250MW is local and the rest foreign. One of such foreign capital projects is Jaguar energy, a 300 MW coal power plant.



### Box III.4. The experience of Enel Green Power in Guatemala

The Enel Group has a presence in 23 countries with a global installed capacity of over 95 TW. Enel entered the Guatemalan power sector in 1999 and is currently operating in the country through its renewables subsidiary Enel Green Power, which has four hydroelectric plants for a total installed capacity of around 80 MW and an 85 MW hydroelectric plant under construction. According to the company, renewables development in the country entails significant challenges from a regulatory, permitting, market, financial and stakeholder relations perspective. Nevertheless, Enel Green Power has proven that projects can be developed sustainably and to the benefit of all relevant stakeholders.

Enel reports that Guatemala being the largest economy in Central America, has a significant potential for the development of renewables. Strategically positioned between Mexico and the rest of Central America, Guatemala can deliver significant value to energy investors.

According to the company, the 11-years old General Electricity Law which liberalized the sector has partly fulfilled its mission by attracting enough investments to ensure security of supply. However, power prices remain relatively high due substantially to increasing commodity prices as well as local community opposition towards the construction of hydroelectric plants.

In Enel's view the successful implementation of renewable projects depends on the pursuit of common benefits, knowledge and respect of indigenous peoples' traditions as well as transparent communications between stakeholders. Another key factor for success is maintaining consistency between messages and actions. Enel usually invests in social projects well before attaining confirmation of project feasibility, to demonstrate that social benefits are not the final step of project development.

The Enel Group, through Enel Green Power, currently focuses its Corporate Social Responsibility (CSR) efforts in Guatemala in the health, education and environmental fields. The company has also organized guided tours to its hydro plants for over 2,500 community leaders. This has contributed to a positive change in local people's perception of hydro power.

Enel considers the following actions necessary to attract more investments in the Guatemalan energy sector:

- To set a clear and stable regulatory framework,
- To strengthen relevant institutions,
- To increase levels of transparency and local institutional participation and governance.

Additionally, Enel is adamant that whatever decisions are made on the above issues, in the clean energy industry, a national plan for renewables is an essential element for any country wishing to diversify its energy generation mix.

*Source:* Interviews with Enel Green Power Guatemala.

The problem of the relationship between investors and the local communities is not limited to the energy sector, as seen in other sections of this report. Investors consider that the Government is not protecting their investments adequately. For instance, distributors report difficulties in collecting payments that have often escalated into episodes of violence against their employees. Generators also claim that the problems encountered in localizing new projects and resolving local conflicts are left in their hands without any government presence to finding solutions.

**Table III.6. Investors' perceptions of the electricity sector**

Favourable conditions	Concerns
The legal framework defining investors' rights and obligation; The payment discipline; The retail tariff level and collection discipline sufficient to assure solvency; The operational control and management freedom; Regulatory commitments sustained through long-term contracts.	The fairness of decisions on tariff adjustments and disputes; The responsiveness of the Government in protecting investors' rights vis-à-vis the opposition from local communities; The fair balance of powers between the public authorities in the sector.

Source: UNCTAD (interviews).

This delicate situation calls for the Government to better define its role and presence when it comes to dealing with the communities. It also calls for companies to find more effective channels of communication. Some generators have been more successful than others in communicating with the local communities. Their strategic approach has consisted in contacting local communities based not only on negotiating compensations in exchange for damages but primarily on showing why and how the future plants can contribute to the specific development of the local community and creating the minimal education and material conditions necessary to seize opportunities deriving from such projects (see box III.4).

In conclusion, the scope for FDI participation as a source of capital, know-how and innovation is undeniable. The challenge for Guatemala will be to conciliate the interests of investors with the general interest of the country to achieve a more reliable, affordable and cleaner electricity supply. The Government needs to develop a strategy for retaining and attracting foreign investors that addresses the key issues identified above, while at the same time ensuring that investment adheres to the Government's social goals. Specific recommendations are presented in the following section.

### 3. Recommendations

The general objectives for the development of the electricity sector set by the Government of Guatemala are in line with the country's future electricity needs. It is apparent that the scope of the investment and the type of technology necessary to deliver affordable, reliable and increasingly clean energy will continue to require the participation of the private sector and, in particular, of foreign investment. This section presents a range of recommendations that the Government should undertake to address the challenges and issues discussed in the previous sections and successfully achieve its energy objectives. The measures, which are hereafter differentiated between policy and regulatory issues and institutional issues, should be initiated in a consistent manner. In this respect, it is important to highlight the need to start developing a comprehensive energy policy right away as an essential building block in the entire strategy for the sector.

#### a. Policy and regulatory issues

A comprehensive energy policy is currently missing. There are several planning documents separately addressing specific issues in generation, transmission and distribution but there is no integrated policy or analysis framework. A national energy policy is required to address in an integrated manner issues like security of supply, efficiency and affordability and environmental sustainability.<sup>148</sup> The Government is aware of this gap and MEM has requested the assistance of the International Energy Agency to develop an integral energy planning study, meant to lead to the adoption of a comprehensive energy policy.

Such a policy should be developed through a public and participative process and be publicly and widely communicated. It would enlarge the investment offer to international community by clearly defining and communicating the Government's priorities in the medium and long run, including in respect to FDI

<sup>148</sup> Good examples of planning processes and documents include Michigan's 21st Century Electric Energy Plan and the South African Third National Integrated Resource Plan.

attraction. A clear roadmap to development will better inform international investors on what to expect (improving predictability), reduce risks and leave them in a better position to make an investment decision. Out of the wide range of issues that this national energy policy would encompass, key specific planning issues pertain to environment, infrastructure modernization and electrification coverage. Below are a few specific suggestions on each.

#### Protect investment while fostering participation by local communities

The opposition by local communities to new generation projects and the problems experienced by distribution collectors faced with a lack of clear support from Government have surfaced as major concerns to investors. The Government should take a public commitment and make visible efforts to implement practical and effective behaviours in order to protect investment and assure law enforcement and property rights. It is not a matter of new laws or regulation but of day to day enforcement.

At the same time, an increased involvement of local communities in the decision-making process related to investments localization is of paramount importance to reduce the current level of conflict and opposition. In this respect, efforts to regulate the application in Guatemala of the ILO Convention 169 should continue.

Also, local communities should share in the benefits associated with the energy projects. An effective instrument would be to introduce a local community tax on power producers. This could help in raising the economic and social development of communities where projects are implemented. A more general instrument could be a law regulating the usage of water as a natural resource and public good (as stated in the political Constitution) for which use a royalty payment to the State should be foreseen and assign a part of the royalties to local communities.

Moreover, existing tools such as the Environmental Impact Assessment should be used more effectively. MARN should clearly define standards of social impact assessment to accompany the EIAs. No authorization should be awarded without consulting the interested local communities.

#### Address threats to sustainability, affordability and competition

Improvements in the legal and regulatory framework concerning subsidies, as well as specific unbundling measures should be considered particularly because these distort the market and contribute to high electricity prices.

Electricity subsidies are a sensitive social issue but they must be addressed because the current scheme is unsustainable and abuses from users that should not qualify for social rates are widespread. A programme targeted to fairness of the entitlements should be established, well communicated and advertised and, in due time, strongly enforced. The Government should therefore re-consider the Social Tariff mechanism. It could limit its application to users with a monthly consumption of less than 50 kWh (e.g. to the part of the population living in poverty). This would redirect government aid to a more appropriate target population, reduce the number of beneficiaries, reduce distortion in market price signal and help address the problem of improving the financial viability of INDE. The cost of the subsidy for this segment of the population would be around \$10 million per year (1 per cent of the total energy sales value).

In addition to reducing the subsidy threshold, the Government might also consider freeing INDE from the implementation of the subsidy scheme by creating a special fund administered by the regulator. Distribution companies would supply all regulated consumers at spot market price and then report the amount of subsidized households to CNEE, which would reimburse the difference between the subsidized and full rate drawing from the fund.

Alternatively, as recommended by the World Bank in its Investment Climate Assessment, the tariff scheme could be removed altogether and substituted with a social support paid to the low income families by the central Government or the municipalities (and not by INDE), and/or compensating the related loss of revenues with minimal surcharges to the remaining users and/or generators.

Reducing or removing the existing subsidy scheme will promote competition in generation and in distribution at the retail level. Liberating INDE of its current subsidy-related obligation and allowing it to freely supply its electricity in the spot market would turn it into a competitive force and help lower prices. At the same time, provided INDE is allowed to operate with a more commercial focus (see institutional issues), reducing the spectrum of subsidized consumption would foster competition at the retail level. At the moment, the two large private distribution groups have a virtual monopoly over their respective geographic areas of service. As the market for unsubsidized consumers grows, trading companies will be inclined to enter, provided the regulator ensures there is no restriction from distributors and access to the existing infrastructure is secured.

A review and assessment of the current spot market price determination rule should be carried out, to ensure that it is still preferable over alternative mechanisms such as the bid pricing rule. As an alternative, a cap on how much additional payment a generator can receive from the spot market on top of its stated variable cost of production could be considered. Changing the current pass-through mechanism for energy cost, which charges the customers for system losses, would also help rates and promote operators efficiency.

Vertical integration is not prohibited by law as long as there is company ownership separation, leading to a risk of price manipulation and possible abuse of market power.<sup>149</sup> The risk is real and the potential for price manipulation should be seriously analyzed. Unbundling hydro from thermal generation will avoid possible market abuses that distort prices. At present, investors that own both types of generation plants are presented with a moral hazard situation whereby they would benefit from suspending the dispatch of cheap hydro energy for that of thermal energy to drive prices up in the spot market.

#### Introduce minimum environmental standard requirements

As part of the comprehensive energy policy, a policy towards climate change and related environmental commitments should be clearly defined and translated into standard requirements. Minimum requirements for environmental performance to be respected by the different technologies and power plants should be publicized and made mandatory by MARN. Adoption of the “best available technology” concept (known as BAT) already used in Europe and the United States of America should be considered. This is applied in regulations that limit pollutant discharges and refers to the abatement strategy. It constitutes a moving target on practices, since developing societal values and advancing techniques may change what is currently regarded as “best available”.<sup>150</sup>

#### Develop appropriate “green” incentives

Full support and promotion should be given to renewable energies to meet the goal of diversifying the electricity matrix. At the moment, the Incentive Law on New Investments in Renewable Energy and its regulation are limited to hydropower, even though Guatemala has significant potential in other renewable sources. Therefore, the Government should update studies on the country’s potential for all sources of renewable energy (mapping potential for geothermal, wind, solar and biomass exploitation) and determine the economic and environmental impact of each. It should also facilitate the process of applying for all related

<sup>149</sup> For example, a parent company owning transmission facilities and power plants could have the temptation to declare some impossibilities in transmission lines in order to force the dispatching of its energy over those of other competitors or block transmission of cheaper hydro energy to keep higher prices in the spot market.

<sup>150</sup> The Clean Air Act of 1990 in the United States and the European Union Directive on Integrated Pollution Prevention and Control (IPPC), 96/61/EC both make use of the BAT concept to control pollutants emission.

permits and licenses through a one-stop shop, and outline procedures for access to funding such as public-private partnerships, trade and sale of carbon credits.

Adequate incentives to attract investment in renewable energies should be introduced. In this regard, European Union member states serve as a good example of alternative incentive schemes for renewable energy. Aside from using direct subsidies and fiscal incentives, European countries have developed three main policies to promote renewable energies: 1) feed-in tariffs; 2) quota systems with green certificates; and 3) tender systems.

#### Adopt a smart grid to channel renewable energies

Infrastructure modernization, primarily in transmission and distribution, is required if Guatemala wants to adopt new generation technologies that can meet the future energy demand. Simply adding wires and equipment without intelligence is not a viable option. The creation of a smart grid (box III.5) will be necessary to accommodate new types of generation that, unlike traditional energies, are variable and non-programmable (e.g. renewable sources depending on wind and sun). In this respect, MEM should consider establishing requirements or incentives for future investments that use smart technologies.

A first step to be taken is the incorporation of smart meters that can measure hourly electricity consumption and display prices that vary with the time of day to increase efficiency in energy use. Experience has shown that providing transparent electricity prices to consumers together with time-of-use rates can lead to consumption reduction that ranges from 5 per cent to 15 per cent. Improving electricity consumption management in a country like Guatemala that has a small reserve margin is crucial, considering that the cost of generating a kilowatt during peak hours can be more than five times larger than during the trough.

#### Continue the electricity coverage expansion programme

The Government should also continue to support the extension of the electrification coverage as the sector expands. In this regard, it could channel some resources to reach portions of the population without electricity services by strengthening the financial capacity of the municipal utilities in charge of distribution. A joint portfolio of rural electrification projects should be developed based on which the Government should seek to attract long-term private investment for development projects in renewable energy.

### **b. Institutional issues**

It is indispensable that investors can trust the Government's impartiality and competence. In this respect, the sector's institutions must be strengthened. An Institutional Capacity Building Plan preparing Government agencies to deal with issues related to grid innovations, new regulations for renewable energies and other planning skills is necessary. Such a plan should strengthen MARN and MEM capacity to:

- Define, develop and communicate clear energy and environmental policies;
- Establish effective standards to select new entrants to deter the entrance of unreliable investors;
- Provide prospective investors (especially in generation) with clear standards allowing them to make their decision on reliable forecast of future costs.

An innovative but effective tool to acquire, maintain and improve the necessary knowledge and experience in a short time consists in building and operating a model simulating the structure of the sector/market. A tool usable for this goal has already been developed by the Francisco Marroquín University: a stable cooperation with that university (and others if any) and the involvement of the other players (generators, transmitters, distributors) in this activity could be really beneficial in providing sector analysis and forecast and at the same time improving the mutual trust and communication within the sector. Also,

a planning unit within MEM should be in charge of coordinating with sector institutions and stakeholders to develop a comprehensive energy policy (section b).

Following international best practice, the independence of CNEE should be, in due course, further consolidated into the law. Full independence from MEM would strengthen the regulator, increase its credibility vis-à-vis investors, and help shield it from accusations of political pressures. In this respect, should a revision of the legislation prove a non-viable option, developing a specific and publicly communicated policy addressing the issues of credibility and accountability would be helpful to further promoting transparency and accountability. This would include submitting CNEE to a periodic audit from an international authority. The International Organization of Supreme Audit Institutions (INTOSAI) provides guides for this type of audit (Correa et al., 2006; USAID, 2009).

Furthermore, in order to fully exploit INDE's potential as an entrepreneur, the legal constraints to its behaviour should be eliminated. It is not a matter of privatization but of transforming a state agency in a state corporation responsible for its industrial plan and its budget. After a first phase of professionalization, a second and definitive phase could be envisaged opening a minority participation in the capital structure to private capital in the stock market. This could allow INDE to play more strongly but more transparently in the market and be a credible partner for joint-venture public-private partnerships (PPPs) for the implementation of big projects, like bi-national or big hydro, and it could even become a regional player. At the same time the social tariff scheme should be reconsidered and the split between transmission and generation companies belonging to INDE should be completed.

Meanwhile, municipal utilities can play a fundamental role in expanding rural electrification. Strengthening their financial capacity and solutions granting them the appropriate autonomy should be evaluated.

Finally, statistical information systems of agents and participants in the electricity market should be developed and improved.

## B. Roads

### I. Background and objectives

Guatemala has a reasonable density of paved roads but they are of poor quality. Successive transport plans have identified needs for additional investment in upgrading and rehabilitation of the long-distance highway network. Urban areas, especially Guatemala City, need new expressways and bypasses to improve traffic flow.

Responsibility for roads in Guatemala is split between the central Government (highways and department roads) and the municipalities (roads within city and town boundaries). So far, all public roads have been constructed and are maintained by public funding, with one exception.

In 1998, the Government<sup>151</sup> awarded a 25-year concession to maintain and operate a 29km section of Highway CA-9 south of Guatemala City to the city of Escuintla and within two years to construct two additional lanes on the remaining section (58km) of the road to Port Quetzal on the Pacific Coast. This (the "Escuintla concession") was awarded to the Mexican company Marnhos. All costs of maintenance, operations and new build were to be paid from the toll with a 1 per cent payment back to Government starting from the third year of the concession.

<sup>151</sup> Through what is now the Ministry of Communications, Infrastructure and Housing (MCIV).

This concession followed an abortive attempt in 1995 to concession the northern section of the CA-9 from Guatemala to Port Barrios on the Atlantic coast. It proved difficult to structure a concession which simultaneously met two requirements namely (i) that any toll road must co-exist with an alternative non-tolled public road so that users have a choice, and (ii) was commercially attractive, given the requirement in contemporary law that a percentage of toll revenue be rebated to the Government.

### **Box III.5. Law on Partnerships for Development of Economic Infrastructure: key provisions**

A new National Agency for Partnerships for the Development of Economic Infrastructure (ANADIE) is to be created. It will be overseen by a council of ministers, officials and representatives of relevant professions (CONADIE). ANADIE is intended to be a centre of expertise in organizing concessions. It sets policy, advises public sector entities on concessions and may execute concessions for public authorities upon request.

Any public sector entity (national or municipal) with rights to contract for public procurement may utilize the services of ANADIE to execute a concession. This is not mandatory but if ANADIE is requested to become the public sector contracting party it is assigned all the public sector entity's rights and obligations in respect of the project. ANADIE undertakes project studies, designs the concession terms, and conducts the bidding process and award under the supervision of CONADIE.

Projects must satisfy technical, cost-benefit, environmental and social impact criteria before being approved for concessioning.

CONADIE, upon advice by ANADIE, must approve any contract before it is sent by the President to Congress to become law. ANADIE appoints a project *ad hoc* Committee to oversee construction, with the assistance of a Project Inspector. ANADIE will include a Supervisory Board that is charged with supervising the operational stage of a concession to ensure that prices and services are provided as stipulated in the concession contract.

In principle, the law will enable any public service to be concessioned and foreign investment will be permitted. However, the law excludes existing public assets from concessioning (thus an upgrading project such as the Escuintla concession would not be permitted in future). Key terms to be incorporated in concessions are:

- The contract period may be up to 30 years (versus 25 years in the Law on State Contracts).
- The public partner may contribute financially to projects. However, 1 per cent of the capital cost of each project must be paid to ANADIE (compared with 1 per cent of revenue in the Law on State Contracts).
- Appropriate assignment of risks between the parties is required.
- Compensation at scheduled rates in relation to construction cost is paid to the winning bidder for force majeure termination of negotiations before contract close or if the contract is rejected by Congress.
- Grounds for early termination are specified.
- Rights of lenders such as assignment of revenues and step-in rights are set out.
- Detailed dispute settlement provisions are made including access to international arbitration.

Source: UNCTAD.

In 1998, the Ministry of Communications, Infrastructure and Housing (MCIV) set up a unit to specialize in concessions and privatization. The objective was to arrange additional concessions within its areas of responsibility, including transport infrastructure. This unit concessioned the postal service but no further roads were concessioned owing to a change in the political climate towards private provision of public services.

The general legal authority for concessions was contained in the 1992 Law on State Contracts covering all national and municipal entities and public enterprises. A short chapter of this law set out the principles, in addition to those pertaining to all government procurement, by which concessions could be awarded. These included stipulating a maximum term of 25 years, the return of the asset free of charge to the State at the end of the concession and the requirement that a percentage of concession revenues be paid to the State. Each individual concession was to be the subject of a separate law and this approach was duly followed with the Escuintla concession.

A general concessions law, the Law on Partnerships for the Development of Economic Infrastructure, known as Public-Private Partnerships (PPPs), was recently approved by the Congress (Decree 16-2010). The key provisions of the new law are summarized in box III.5.

The new law is far more comprehensive than the brief provisions of the Law on State Contracts and clearly benefits from international experience on concessioning gained since the 1992 law was enacted. The concessioning provisions of the 1992 law have not been repealed and presumably could be utilized to award concessions outside the new framework.

A preliminary indication of Guatemala's ability to execute concession projects is contained in the recent compilation of PPP Preparedness rankings for Latin America and the Caribbean.<sup>152</sup> Unsurprisingly, given its long history of concessioning, Chile ranks best in the region. Guatemala ranks only 16th of 19 countries. Guatemala's ranking in relation to selected Central American and Caribbean countries is shown in table III.7. Individual components of the rankings are shown in table III.8.

**Table III.7. PPP Preparedness: Selected Country Rankings 2009**

Country	Ranking (of 19)
<b>Guatemala</b>	<b>16</b>
Costa Rica	5
Dominican Republic	8
Honduras	11
Panama	15
Nicaragua	18

Source: Economist Intelligence Unit (2009).

**Table III.8. PPP Preparedness scores by constituent indicator 2009**

Indicator	Top country score	Average country score	Guatemala score (rank)
Legal and regulatory	61.1	29.6	<b>19.4 (13th)</b>
Institutional framework	62.5	31.5	<b>25 (9th)</b>
Operational maturity	77.8	43.1	<b>33.2 (17th)</b>
Investment climate	93	59.6	<b>37.1 (18th)</b>
Financial facilities	95.8	43.7	<b>29.2 (12th)</b>

Note: points from 0 worst-100 best.

Source: Economist Intelligence Unit (2009).

<sup>152</sup> The Multilateral Investment Fund, administered by the IDB, commissioned the Economist Intelligence Unit to compile the rankings. The first assessment was published in June 2009.



## 2. Sector analysis

In order to be successful, road concessions<sup>153</sup> should deliver the following outcomes:

- Good socio-economic benefits;
- Roads that are at least as well constructed, maintained and operated as could be achieved by public works;
- Perceived value for money to users;
- Financial success for investors.

This analysis sets out ten principal tests that will determine whether Guatemala is able to attract private investment, including FDI, into road concessions on terms that are likely to benefit Guatemala. These follow largely the recent UNCTAD analysis of best practices in road concessions (UNCTAD 2009). The issues are:

- 1) *Plan*: are the road projects derived from a multi-modal transport plan and thus likely to be priority projects with strong public benefits?
- 2) *Project pipeline*: has a pipeline of well-tested projects been identified and prepared that are suitable for concessioning?
- 3) *Policy*: are the policy variables that shape successful concessioning likely to be understood and applied?
- 4) *Expertise*: will the Government develop and deploy appropriate expertise to handle the complex policy and commercial issues involved in concessioning?
- 5) *Champion*: will a senior minister or ministers take active responsibility for ensuring the successful execution of concession projects?
- 6) *Project execution and control*: is the Government prepared to undertake its project obligations as a contractual partner rather than in its familiar principal/client role in public works procurement?
- 7) *Capital market and financing*: can the local capital market and banking system provide long-term local currency finance?
- 8) *Local participation*: are local contractors prepared for the scale, complexity and operating issues that differ in concessions from public works contracts?
- 9) *Competition*: whilst bidding may be *de jure* competitive, will there be sufficient competition in practice? This issue arose from the fact-finding mission as a specific Guatemalan issue.
- 10) *Foreign investors*: What types of foreign direct investors are realistically available to invest in Guatemala's transport infrastructure?

### a. Transport plan

The first step in attracting beneficial FDI is to ensure that the projects offered for concessioning are in accord with the strategic priorities for national development. In this regard, toll roads are no different from roads undertaken with public funds. Both should originate from a coherent multimodal transport plan. A transport plan also has the benefit of providing the basis for developing a pipeline of projects which (as discussed in the next section) helps to attract FDI.

<sup>153</sup> This analysis focuses on concessions that lead to *new investment* in roads and does not cover non-investment forms of concessions, such as concessions for maintenance.

Transport planning is long-standing in Guatemala including:

- The 1996-2015 Transport Master Plan;
- The Road Development Plan 2000-2010;
- The Multimodal Plan for Transport Infrastructure Works (PMOIT) 2008-2015.

The PMOIT (PRONACOM 2007) is an especially useful starting point as it was based on a study sponsored by PRONACOM as part of the National Competitiveness Programme (2005-2015). It takes a strategic and holistic view of infrastructure needs for greater access by business to global markets and by the community to services. Interrelationships between the transport modes (especially roads, seaports and airports) were considered and priorities and timelines established. The PMOIT identified an integrated set of priority projects from 2008 to 2015 requiring total investment, based on indicative costs, of:

- Roads: \$1.95-2.5 billion;
- Ports and logistics infrastructure: \$410-470 million;
- Airports: \$122-142 million.

It is clear that roads are by far the largest component of future transport infrastructure investment needs, suggesting a potential role for private investment to supplement public funding. The PMOIT study estimated that \$570-650 million of road investment could be suitable for concessioning.

This planning work has recently been reviewed and refined into two road planning documents prepared by MCIV:

- Road Development Plan 2008-2017 estimating road investment needs of \$4.59 billion;
- Strategic Mobility Plan for the Central Area of Guatemala (MCIV 2009), which proposes detailed studies for radial and ring road projects in the area of Guatemala City with preliminary investment costs of \$4 billion.

Guatemala has produced many transport plans. Many projects recur in later plans so it is safe to say that actual investment has been much lower than proposed. However, the work entailed has formed common themes around the locations and types of road projects that are a priority from the standpoint of the national Government. The next section examines whether these have developed into a project pipeline that could attract private investment, especially FDI.

#### *b. Project pipeline*

A project pipeline is important in attracting FDI because the principal foreign investors are likely to be construction companies or the infrastructure units of construction companies. Often, their investment is a means of obtaining construction work rather than long-term operating rights. The prospect of a flow of work helps foreign construction companies to commit to establishing the facilities and relationships in the host country necessary for their construction business.

Once the new concessions law is approved, the Government expects that projects suitable for concessioning will be identified in the second half of 2010 and start to become available for bidding in 2011. This is unlikely as the project-specific technical and financial studies appear to be no more advanced than pre-feasibility stage. It is likely to take three years before a pipeline of concession-ready projects is available. Possibly one priority project could be fast-tracked and be available for concessioning within two years.

Projects should pass stringent cost-benefit assessment and receive environmental approval before they can be considered for selection as concession projects. Part of the selection process should involve

developing a public sector comparator model for each candidate project to determine whether a concession approach (with due allowance for the transfer of risk to the private investor) would deliver better value than traditional public works procurement. The public sector comparator discipline has yet to be developed in Guatemala.

In practice, the road projects most suitable for concessioning are:

- Large and complex projects - they entail more construction risk and a well-structured concession will pass this risk to the private investor;
- Heavily trafficked and toll evasion is difficult; and:
- Have a competing public road that is free to users;
- Offer users value for money.

So far preparatory work in Guatemala has not been sufficiently detailed or systematic to produce a pipeline of suitable concession projects. However, official documents sometimes “mark” projects as possible concession candidates. These are in three categories, as shown in box III.6. However, it must be emphasized that all have to pass cost/benefit tests and receive environmental approval prior to consideration as candidates for concession. In some cases, the engineering and surveying work has to be done in much more depth. The Government is aware of this and MCIV is requesting funding for the detailed technical and financial investigations needed.

There are some serious question marks over whether the Government would proceed with many of the projects on the long-list set out in box III.6.

- i) The new law prohibits concessioning of existing projects.<sup>154</sup> In the roads sector, this would mean that road improvements such as rehabilitation, paving, widening with additional lanes, adding exit ramps and flyovers and tunnels would not be allocated for concessioning. It may be difficult to obtain public support for introducing tolls on roads that have already been constructed with taxpayer funds and where users are already supporting maintenance through fuel taxes. On the other hand, the improvements can give good socio-economic outcomes, including much-improved road safety, and these projects can be concessioned on attractive terms because key investor risks (construction and traffic volumes) are more predictable.
- ii) The municipal authority of Guatemala City is not in favour of the Guatemala City ring roads and expressways (although a major part of them would be national rather than municipal roads) as they would increase the commuter influx to the city and the pressure on city services. The municipality’s objective is to encourage higher density within the city. It is catering for existing commuters by improving bus services through setting aside bus lanes and concessioning bus shelters and interchanges to private investors. It points to Bogotá, Colombia as having a successful strategy of this kind. Yet, at this early stage the Guatemala City projects could be viable toll roads for concession and a very important component of building up a pipeline of concession projects. They are heavily trafficked and meet the primary policy criteria of having competing free alternatives.
- iii) The policy requirement that toll road users have a free public alternative could further reduce the list of candidates, since much of Guatemala’s highway network is already in place.

In combination, *these constraints severely reduce the scope for attractive road concessions*. It is not desirable to relax the policy requirement that toll road users have a free public alternative, for reasons set out above. This means that efforts should be made to reach a mutually satisfactory agreement with the municipality of Guatemala on the projects proposed there.

<sup>154</sup> Article 1 of Law 16-2010. A view was expressed in the National Workshop that improvements to existing projects would not be prohibited but would run into popular resistance as being akin to privatization.

### Box III.6. Long list of possible candidates for toll roads in Guatemala

#### Highways

The Central American network of highways (CA) links Guatemala to its ports and neighbouring countries. The busiest of these highways are those connected to Guatemala City namely the C9 and CA1. A 2009 update of the PMOIT suggests the following as suitable concession projects:<sup>155</sup>

- Pacific Corridor (CA2 Mexico to Honduras passing south of Guatemala City through Escuintla): road widening (to 4 lanes) and other improvements on certain sections. Indicative capital cost: \$543 million.
- Atlantic Corridor (CA13 road in far north to Honduras): improvements. Indicative capital cost: \$382 million.
- Inter-ocean corridor (CA9 linking Pacific port of Quetzal with Atlantic port of Barrios): widening to 4 lanes. Indicative capital cost: \$816 million.
- Caribbean tourist corridor (CA13 Mexico-Guatemala): paving and improvement of frontier stations. Indicative capital cost: \$230 million.

From time to time three other candidates for concessions have been mentioned but are not prominent in any of the aforementioned transport plans. The first is a new second Pacific Corridor road, south of the CA2, which would run between the Mexican and Honduran borders. The second is a new toll road paralleling the CA9 north of Guatemala City. Third, sections of the Franja Transversal Norte (FTN) linking Mexico, Guatemala and Honduras totalling 332.5 km are listed for private finance with a cost of \$2 billion but it is understood that these will not be concessioned.

#### Guatemala city

Guatemala City is variously estimated to have a population of between 1.25 and 2.5 million and is the largest city in Central America. Another 1 million people commute daily to work in the city.

The Government is proposing major road works to reduce congestion and improve traffic flow including:

- An outer ring road (anillo) connected to the CA2 and CA9 highways to improve the flow of port and frontier traffic converging on the city.
- An inner ring road to relieve congestion.
- Four radial expressways into the centre of the city.

These projects involve 200km for the ring roads and 200 km of expressways and have an indicative capital cost of \$4 billion. (MCIV 2009a). The Government is proposing that the ring roads should be concessioned in sections (*tramos*). Certain sections of the proposed outer ring road have been prioritized (including a south eastern section linking the CA9 and CA2 highways). This will increase the need to plan for interoperability of tolling systems if concessions are won by different operators and electronic tolling is adopted.

#### Other city improvements

Current plans of MCIV include a number of bypasses or expressways in 17 smaller cities located on the major highways. Indicative costs range from \$6 to \$23 million per project. These are possibly suitable for small scale concession contracts but would be too small to interest new foreign investors.

Source: UNCTAD, based on government documents supplied.

<sup>155</sup> Capital cost estimates of highway projects are sourced from PRONACOM (2009).

### c. Policy

A successful road is one which delivers excellent socio-economic outcomes. When it is a toll road, it should also offer value for money to users. At the core of the latter outcome is establishing general policy which transfers as much as possible of the commercial risks of construction, operations and maintenance to private investors. The private investor should be in a position of having to attract customers through the superior value offered by quality of the road construction, high standard of maintenance, a good safety record and a competitive toll.

Guatemala has already established the foundation of good policy by requiring that users of a toll road must have access to an alternative public, non-tolled, road.<sup>156</sup> This establishes a source of competition for the toll road.

The two objectives of good socio-economic outcomes and value for money need to work together. There will be road projects that have strong socio-economic outcomes but cannot be commercially viable against alternative public roads. These can merit an appropriate public subsidy. The design of this subsidy policy and its application to individual projects is yet to be developed in Guatemala. Peru, for example, offers a standard subsidy equivalent to the average national maintenance cost. It might also underwrite certain minimum levels of traffic, as is also the case in Chile.<sup>157</sup> Some countries may apply a subsidy in the form of a contribution to capital costs – normally on a last in basis.<sup>158</sup> The level of subsidy can be determined *ex ante* or through the bidding but in all cases should be targeted so as not to remove the commercial imperative on the investors to attract users to a well-constructed and well-managed road. Importantly, the proposed concession law does not rule out the provision of subsidies – unlike the 1992 law which mandates that the Government receive a revenue contribution from concession projects.

Apart from these primary policy issues, there are many other policy and related institutional issues that will need to be decided on a general and/or project-specific basis. These include design of the competitive bidding process (including scope for innovation in proposals); detailed risk assignment; and the application of key performance indicators. The proposed law will enable ANADIE to be flexible in allocating risk on a case-by-case basis. Detailed discussion of the issues is outside the scope of this analysis but two areas of risk allocation merit highlighting in Guatemala's case.

- Land acquisition and population resettlement. New roads or road upgrading will require land and possibly resettlement. Either party could take this risk. Marnhos reports no difficulty in its widening of the CA9 south.<sup>159</sup> But in the light of the community issues faced by some recent resources' projects, this risk should probably be taken by the Government. This could mean that any resettlement must be completed and any community issues settled before opening concession projects to bidding.
- Since tolls are charged in local currency, foreign investors and foreign lenders may seek some guarantees to cover foreign exchange convertibility risk and exchange rate risk. Guatemala may need to show some flexibility in this regard as it is likely that major projects would need to go beyond local banks and the small local capital market (see below). There are various examples of approaches taken by other developing countries. For example, Chile's approach of limited exchange rate guarantees would be worth considering.

<sup>156</sup> In Australia, which has many examples of both good and poor outcomes, this is referred to as giving users a "reasonable competitive alternative".

<sup>157</sup> Traffic forecasting, especially for new roads, is notoriously difficult yet is the key to securing investment and finance. Investors in the EastLink expressway, which opened in 2008 in Melbourne Australia, commissioned three independent traffic forecasts – all of which over-estimated traffic levels. Conversely, traffic on Peru's Southern Inter-ocean toll road had, by early 2008 in one section, already reached projections for 2015.

<sup>158</sup> It should be noted that a government contribution to capital costs also helps to assure investors of the Government's long-term commitment to the project.

<sup>159</sup> On the other hand, delays were caused in completing new lanes in two road concessions in Peru by resettlement difficulties. These occurred even though the land occupied was part of the original road reserve and the inhabitants were illegal squatters. In these cases, the investors had accepted land acquisition risk and, no doubt, regretted it.

Foreign investors, in particular, will have specific issues on expropriation and dispute settlement. Based on Guatemala's general approach in law and treaties (as reviewed in chapter II) there is no reason why these should be problematical in concession contracts. However, the Government should be prepared to allow more scope for expert determinations rather than have recourse to the courts or arbitration to handle contentious issues. Any contract, especially one that may last up to 45 years will invariably require ongoing interpretations and adjustments.<sup>160</sup>

d. *Expertise*

Concessions involve complex public policy and commercial issues that must be understood and knitted together to structure and execute each transaction. Moreover, the key terms, many of which have a direct impact on the public, are locked in for up to 25 years or more. A central core of expertise within Government must be developed to handle these issues. Even within transport infrastructure sector of ports, airports, roads and rail, there are many different business and public policy characteristics. Nevertheless, there is much knowledge that applies to all such projects and a means of institutionalizing, retaining and nurturing such knowledge is needed especially in developing countries. In Peru for example a standing specialized committee of eminent persons reviews all transaction documentation.

Guatemala's proposed concessions law establishes a new specialized agency, ANADIE, to execute infrastructure concessions, including toll roads, based on the approach taken in Chile. This is an excellent means of institutionalizing the expertise. However, it is not obligatory for individual ministries and municipalities to utilize the new law (and the expertise of ANADIE) if they wish to undertake concessions. Public sector entities could arrange concessions through the rights given in the 1992 Law on State Contracts and bypass ANADIE completely.

It is important that the unique expertise which ANADIE will develop over time be used by all public sector entities, even in transactions where ANADIE is not the contracting party. To ensure this, it is recommended that CONADIE be required to approve all concession projects of national government entities including those not carried out under the proposed concession law. This will help to ensure that ANADIE's advice is sought on key stages of the concessioning process. Constitutionally, it may not be possible to oblige municipalities to have the approval of CONADIE for city and town road concessions. In practice, such projects may require national Government financial support or guarantees and these should enable larger projects to come within the ambit of CONADIE.

The new law provides a good framework for developing the necessary institutional expertise. Substantial funding will be needed to develop ANADIE into a centre of expertise. It also requires sustained funding to maintain that expertise. As a pipeline of projects is executed, they will generate some revenues to ANADIE from fees. But launch funding and underwriting of operational costs is needed from the Government. The Government should study the size and resources devoted to concessioning in countries with lengthy experience, such as Chile and Peru, to identify an appropriate budget.

e. *Champion*

In the usual risk allocation in a concession contract, the public partner may accept some important project delivery obligations. These can include major matters such as land acquisition, population resettlement and environmental approval which, in Guatemala's case, should probably be secured prior to tender (as discussed above). Other obligations during construction can include timely delivery of traffic management/street closures, relocation of utilities, permissions to fell trees, municipality permits and health and safety permits. These matters often involve various government agencies who have little direct connection to the project. Yet, delays can lead to project slippage and cost overruns.

<sup>160</sup> Melbourne's, City Link toll road contract was amended three times in the first three years.

Good practice is to ensure that a senior ministerial group is empowered to cut red tape and facilitate decisions including dealing with unforeseen events.<sup>161</sup> It may even be necessary for this group to have specific override powers as part of the project legislation.

f. *Project execution and control*

Concessions are a *partnership* between the State and the investor and each has rights and obligations as set out by the concession contract. Despite its title of Infrastructure *Alliances* the proposed law misunderstands this by setting up project inspection mechanisms that are more like the principal-client relationships in public works contracts. Article 78 of the proposed law provides for a Project Inspector during the construction phase. This inspector reports to an *ad hoc* committee of officials and can unilaterally impose fines or sanctions on the private partner. There is also a position (Article 79) of Project Superintendent during the construction period with similar powers and it seems that an official from the Auditor-General may also be involved in close supervision.

The best way to reflect that a concession is a contractual relationship in which both parties have obligations is to appoint an Independent Project Certifier (IPC) for the construction phase. The IPC verifies that each party is performing its obligations in accordance with the agreed Key Performance Indicators. This includes approving detailed designs and verifying that construction standards are maintained. Australia has successfully used this approach. The IPC is a senior engineer, supported by a professional team, who is *approved by both parties and independent of both*. Peru has followed the approach proposed in Guatemala's draft law and it has led to one-sided and heavily bureaucratic mechanisms that have slowed project construction. These uncertainties are a deterrent to investors.

Adopting the IPC approach involves a change of mindset from the command and control approach of public works contracts using public funds. At the heart of this change is to ensure proper transfer of commercial risk so that the private partner has the incentive for the timely construction of a good standard road that can be operated successfully.

g. *Capital market and financing*

The national stock exchange of Guatemala (Bolsa de Valores) has been operating since 1987 and is a private company owned by local banks. It has only 17 listings and an amount equivalent to only around \$32 million had been traded in 2009, as at 30 November. It has not become a significant means of mobilizing equity capital. Neither retail nor institutional participation is well-developed. The latter is important. Pension funds in particular are natural sources of long-term infrastructure funding.<sup>162</sup> In Guatemala, the social security funds invest in government securities. These funds are not privately managed and the framework is not in place to provide liquidity and investment expertise to the equity market. Moreover, it is reported that the Government does not pay its commitments to social security for public sector staff and thus another potential source of infrastructure funding is unavailable.

The corporate bond market is also not developed. Banks and insurance companies are permitted to invest in corporate bonds, in the latter case only if the securities are rated. Neither has invested in any of the corporate bond issues currently in the market. Again, bank and insurance company funds are largely invested in government securities. Mexico has introduced a new type of security for infrastructure - capital development certificates - which are debt instruments but with an equity upside designed to suit its pension funds. Guatemala should be studying these kinds of instruments as part of reforming the market for institutional investors.

<sup>161</sup> For example, Peru has instituted a mechanism for dealing with archaeological finds that may be uncovered by road excavations. This has obvious relevance to Mayan artefacts and remains in Guatemala.

<sup>162</sup> Chile's pension funds have been a vital source of concession finance in that country, for example.

There is no specific legislation governing collective investment schemes such as mutual funds although forms of investment companies and trusts are available. A particular gap is the absence of appropriate tax provisions to avoid double taxation on the pass through of dividends, interest and capital gains to unit holders.<sup>163</sup> The taxation of distributions to non-resident unit holders is also unclear. This militates against investment by foreign mutual fund such as emerging market specialists who could be a valuable source of funding.

The proposed concession law provides adequately for project finance including sponsor guarantees to lenders and for approval of step-in rights for lenders. There is encouraging evidence that local banks are interested in providing funding. At least one bank is already doing preliminary planning with potential local bidders. However, local debt finance is probably limited to about \$100 million per project.

#### *h. Local participation*

There appears to be a strong appetite and capacity among local companies, both construction companies and the conglomerates, to take part in concession projects such as toll roads. The Chamber of Contractors estimates that at least four Guatemalan construction companies could invest \$100 million per project; another six could invest up to \$50 million; and a further 6-10 up to \$25 million per project. Some in the industry have studied toll road projects in Chile and Mexico. Guatemala also has several large, closely held conglomerates some of whom are interested to be developers and operators of toll roads. Certain of these have invested in other concessions in other sectors such as power generation projects. The financial capacity and interest of local industry is strong for a mid-sized developing country.

Two issues arise from this welcome level of local interest. Will local investors be willing to associate with foreign owner-operators or foreign contractors<sup>164</sup> or will there be pressure to package up smaller projects to suit the local industry? Smaller projects could lose benefits of scale and advanced technical capacity and lead to a multiplicity of tolling systems on linked roads. The second issue is of ensuring competitive outcomes as explained below.

#### *i. Competition issues*

Chapter II reviewed the apparent lack of competition in many industries in Guatemala and noted the absence of a competition regulator. The road construction materials industries are no exception. There are dominant suppliers in most segments (see chapter II). In theory, some of these supplies could be imported but at least in the case of cement it is alleged that “no-compete” arrangements among leading regional suppliers allow them to fix prices of cross-border supplies.

It will be important that lack of horizontal competition does not lead to vertical arrangements that restrict competitive bidding. This can arise if suppliers form alliances with one investment consortium and freeze out other bidders directly or indirectly. For example, there is a suggestion that a leading cement company has formed an alliance with a leading contractor and major local bank to bid for concession projects. Such forward planning is welcome but dominant suppliers should not form exclusive arrangements.

Non-competitive arrangements are likely to reduce the value for public money invested in any road projects whether these are implemented by traditional procurement or by concessions. Yet they are especially likely to be a barrier to bidding by consortia that include new foreign contractors who are less likely to have established relationships with the supplier industries. To combat this problem the authorities should consider two measures:

<sup>163</sup> This is less of a concern for dividends since there is no tax on dividends paid to residents.

<sup>164</sup> This has been a common practice in other Latin American countries such as Argentina, Chile and Peru. In Peru, the local industry has benefited from the expertise of the major Brazilian contractors in the construction of large and challenging Greenfield projects and has then taken a leading role at the operation stage.



- Establish a register of approved local suppliers of the major materials for each tender offer. In order to be approved a supplier must certify that it will quote and supply materials to all bidders if requested on equal terms. Bids will not qualify unless they use supplies from approved suppliers or imported materials.
- On a project-by-project basis remove any restrictions on imports or duties on imported major materials.

j. *Foreign investor types*

In principle, foreign direct investors may be of three types (and indeed may associate in bid consortia):

- 1) *Owner–operators*: These are usually construction companies who have grown their business model to include investment in and operation of toll roads. In many cases specialist infrastructure affiliates are established to be cross-border investors. Owner-operators may also originate as special purpose vehicles set up to own and operate a single project with funds drawn from the public capital markets. Once the first road operates successfully, such vehicles may invest in additional projects at home but, so far, rarely abroad.
- 2) *Contractors*: these are construction companies whose principal objective is to win construction business. Their business model is to invest as little as possible<sup>165</sup> and to exit the project once construction is completed. Thus they typically associate in bid consortia with other construction companies, owner-operators and financial investors. Nevertheless, in countries with weak capital markets they may be principal investors<sup>166</sup> and their financial and technical capacity become vital ingredients in securing project debt finance, local partners and financial investors.
- 3) *Financial engineers*: these are banks with specialist infrastructure units that organize bid consortia, invest own and captive funds and may participate in operational management. They have been less active in the aftermath of the global financial crisis as the availability of public equity and project debt finance has shrunk.

*The owner-operators*

World-wide there are probably around 90 companies that invest in and operate toll roads and another handful that are specialist providers of tolling systems. Many of these companies are special purpose vehicles formed to construct and operate a single toll road. Others are diversified companies whose toll road interests are minor or ancillary to their principal business interests. In neither case have they ever made a cross-border investment in toll roads. In other words, they are not multinational companies. Together, they make up the vast majority of the 90 companies in the industry.

Among owner-operators who have undertaken FDI there is a small but growing group who have shown interest in investing in low and middle income developing countries.

- Historically, large European owner-operators such as Ferrovial and Abertis (Spain), Vinci (France) and Atlantia (Italy) have concentrated their FDI in the EU and other developed countries. Ferrovial (through its affiliate Cintra), Itinere (Spain) and Abertis were early investors in pioneering Chilean and Argentine toll roads. Nevertheless, these are small parts of their international toll road holdings and both Cintra and Itinere have recently sold some of their Latin American toll road interests.
- Now a second wave of European owner-operators is emerging in Latin America. These include Atlantia with Brazilian and Chilean toll roads acquired in 2008/9; Brisa (Portugal) with a new concession in Brazil, Impregilo (Italy) with projects in Argentina and Brazil and OHL (Spain) with

<sup>165</sup> In Australia's toll roads developed by special purpose vehicles, the construction companies invest no more than 15 per cent of equity or 7 per cent of overall project cost.

<sup>166</sup> Peru provides an example of this. Its capital market is reasonably well developed, but the inter-ocean roads projects were too large to be financed locally.

investments in Argentina, Brazil, Chile, Mexico and Peru. Closer to Central America, Global Via (Spain), a 2007, start-up bought concessions in Chile and Costa Rica and has bid in Mexico. Shikun & Binui (Israel), which has won construction contracts in Guatemala, may also fit this picture.<sup>167</sup> It has established a Swiss-domiciled specialist infrastructure unit to invest in developing countries, including Latin America.

- The recent emergence of the new European owner-operators is due to new toll road opportunities in the larger Latin American countries such as Colombia and Mexico but above all to the rapid growth in opportunities in Brazil which has made remarkable progress in improving the regulatory regime for concessions in the last five years.
- Some Latin American based owner-operators have emerged, typically as infrastructure units of construction companies. These include IDEAL and Marnhos (Mexico), Besalco (Chile), Hidalgo & Hidalgo (Ecuador) and ISA (Colombia). Some of these have already made small cross-border investments usually in neighbouring countries. The Marnhos investment in the Escuintla concession in Guatemala is an example.
- FDI by larger Asia-Pacific companies is regional. Hopewell and Cheung Kong (Hong Kong, Special Administrative Region of China) principally invest in China. Transurban (Australia) is a rare example of a special purpose vehicle that has expanded internationally by investing in the United States of America.

#### *The contractors*

- The largest construction companies in the Americas have generally stayed close to their traditional business model by associating with bid consortia and utilizing their financial and technical muscle to provide the completion guarantees on which project debt finance rests. Bechtel and Fluor Daniel (United States of America) are associated in this way with large projects at home and abroad. The same is true of the large Brazilian companies such as Odebrecht, Comargo Correa, Andrade Guterrez and Queiroz Galvao. ICA (Mexico) also fits this model. In Peru, the Brazilian companies all took unusually large investment roles in major Greenfield projects intended to link Peru with Brazil. These reflected the strategic priorities of the Governments concerned. It is not yet clear if Guatemala will present projects large enough to attract these majors. Among the European corporates, Dragados (Spain) has been involved in Chile.

#### *The financial engineers*

- Macquarie (Australia), Citi and Goldman Sachs (United States of America) have been active principally in the developed countries and larger developing countries where there are large projects and deeper pools of capital. So far they have not been active in small developing countries. In Central America, Goldman Sachs has been involved in a toll road bid in Mexico in association with a local construction company.

Knowing the difference between these types of investors is necessary to profile and develop a database of potential investors and target them according to their specific characteristics.

### **3. Recommendations**

Guatemala has made initial steps towards launching a road concession programme that could attract FDI to projects with good socio-economic outcomes. These steps are in the right direction but, in reality, there is a long way to go and progress is slow. It will take three years of hard work before FDI can be attracted on good terms for the beneficial projects. But this time will not be wasted if it results in good preparation for private investment, including FDI.

<sup>167</sup> In Guatemala (where it is widely known as Solel Boneh) it won the construction contract for the FTN in 2007 and in 2009 the construction contract for the Pala Viejo hydropower project.

Two positive initiatives stand out. First, the law provides for a generally sound institutional and policy framework for concessions in all sectors, including roads. Second, there is the basis of a coherent multimodal transport plan and a start in identifying suitable projects.

The following issues should be addressed if roads concessioning is to succeed:

- 1) A substantial *project pipeline* of well-prepared high priority projects should be established to attract investors. Current lists are changeable and contain “wish-lists” of projects that are not fully prepared for investment. Transport plans roll over. The presentation is not credible to investors. To speed up project preparation the Government should:
  - a. Give MCIV more support to commission the detailed technical, financial, environmental and social studies required to select and prepare projects;
  - b. Move more quickly to develop the expertise (e.g. within MCIV or ANADIE) to decide which roads will be suitable for concessioning versus traditional public works funding;
  - c. Take the initiative to obtain environmental approvals, acquire land and resettle people as part of the preparation of projects and prior to tendering. Given difficulties in these matters, these risks are unlikely to be transferable to investors.
  - d. All these actions require government funding. Attracting private investment to roads will save government funds in the long term but achieving good projects requires substantial government funding up-front.
- 2) ANADIE must be adequately and sustainably funded if it is to develop into a centre of expertise to handle the complex issues involved. The proposed 1 per cent fee on the capital cost of projects will not get ANADIE off the ground or guarantee sustainable funding. The experiences of Chile and Peru should be studied to assess budgetary requirements.
- 3) The prohibition on the concessioning of existing projects is an unfortunate step and the policy, which should be retained, that a toll road must co-exist with a free public alternative together severely restrict the scope for road concessions. It is all the more important then to address the objections of Guatemala City municipality to ring roads and expressways which, *prima facie*, are the prime candidates for concessions in Guatemala.

It is recommended that Congress, in due course, should introduce some flexibility in the form of a substantiality waiver. Existing roads could be concessioned on two conditions:

- a. they result in substantial improvements (such as new lanes);
- b. the tolls reflect only the improvements brought by the investor.

This would need to be accompanied by a public education campaign to differentiate such projects from conventional “privatization” which is not popular.

- 4) Policy and procedures proposed in the proposed concessions law are generally sound and should enable concessions to be arranged in a manner that balances the public interest with investors’ requirements. However, the contractual nature of concessions is misunderstood in the control provisions of the proposed law which mandates inspection and control systems based on the principal-client relationships in public works projects. In a concession contract *both* parties accept performance obligations. They should appoint an *Independent Project Certifier* to work in the construction phase to ensure that both fulfil their obligations.
- 5) Concession projects need *political “champions”* to cut red tape and ensure that the Government’s obligations for project delivery are met. This should be at ministerial level on a project-by-project basis. If investors have good experiences in the first project this will help to attract more interest in subsequent tenders.

- 6) Balancing the public and private sector interests in concessions is a complex task. The creation of ANADIE should enable the necessary accumulation of *expertise* to perform this task well and consistently. ANADIE should be empowered to review the terms of all significant concession contracts including those to be implemented by agencies and municipalities under the 1992 state contracts law.
- 7) *Local contractors and the local capital markets play an important role in concessions*, even where FDI is involved. Guatemala's construction companies and conglomerates have a greater capacity and interest in participating than is usual in a smaller developing country. However, the local capital market which provides local currency investment and finance is poorly developed. Reforms are needed in the management and investment rules of pension funds, in regulations and tax rules for mutual funds and in the development of investible instruments for long-term concessions.
- 8) There is a *lack of competition in the materials supply industries*. Steps should be taken to ensure that they do not lead to non-competitive bidding for road concessions. Two steps are recommended for each project:
  - a. Establish a register of approved suppliers who undertake to quote the same terms to all bidders and only accept bids from consortia whose suppliers are so certified.
  - b. Allow duty free entry of imported building materials.

## C. Mining

### I. Background and objectives

Guatemala is believed to have high mineral potential especially for gold and nickel although production is still small and the country is relatively lightly explored. In modern times, especially after the civil war, it attracted some FDI in exploration and mining of metals.<sup>168</sup> But mining has a contentious history especially in relationships with indigenous communities, in its environmental impact and in its contribution to government revenues.

Exploration and mining activity is now only on a modest scale, accounting for typically less than 1 per cent of GDP (although investment by the Canadian miner Goldcorp in the Marlin and Cerro Blanco gold projects since 2003 has been a significant boost to the industry and to overall FDI inflows to the country). Gold is the dominant minerals product but despite the rapid rise in national production due to the Marlin mine, Guatemala produced less than 1/3rd of 1 per cent of world gold output in 2007 and ranked (in 2006) 36th country in volume of gold produced.<sup>169</sup> However, development of other gold deposits such as Cerro Blanco will boost Guatemala's ranking as an international gold producer. Nickel is not yet mined but has commercial promise, especially in the Phoenix deposit which, if fully developed, would rank among the largest 10 nickel mines world-wide. The principal minerals ventures in Guatemala are described in chapter I.

The Government wishes to address outstanding issues and attract new investment on terms that enable mining of metals to make a contribution to development. There have been extensive reviews of mineral policy and efforts to revise the Mining Law of 1997. A High Level Commission on Minerals with government, academic and church representation was established in 2005 to review these issues prior to submitting a 2006 draft new mining law to Congress.

In 2007, a minerals strategy for the period 2008-2017 was issued.<sup>170</sup> It contains the following unimpeachable national objectives:

<sup>168</sup> This report deals with mining of metallic minerals and not industrial and construction materials.

<sup>169</sup> Global output figures are sourced from British Geological Survey (2009).

<sup>170</sup> 481-2007 of 18 October 2007.

- Promote the technical and rational development of mineral resources;
- Modernize the legal and regulatory system;
- Strengthen community development in mining areas;
- Develop stakeholder dialogue in the mineral licensing process;
- Strengthen environmental protection.

The latest draft of the mining law was presented to Congress in early 2009, following the report of a tripartite Technical Commission of the Congress with the participation of government officials and the industry. But substantive policy making is in disarray. On 19 June 2008, the Constitutional Court ruled that seven articles in the Mining Law (Decree 48-97) are unconstitutional, specifically those that refer to the emission of licenses. In practice, this created a “technical moratorium” on granting further mining licenses until there is a national consensus about reforms to the Mining Law.

## 2. Sector analysis

### a. Legal and institutional regime

In Guatemala the subsoil resources are owned by the State and the Ministry of Energy and Mines is charged with issuing mining rights to private investors under the Mining Law (of 1997). Mining rights (which include reconnaissance, exploration and mineral extraction) may be granted to both national and foreign investors.

Guatemala’s three kinds of mining licence right are common world-wide but contain some features that are unusual.

*Reconnaissance licences* are granted for 6 months but may be renewed. Unusually, in Guatemala, they are exclusive although this is balanced by their short term nature. The Government is proposing to abolish reconnaissance licences due to a concern that the accumulation of such licenses (which can cover up to 3’000 square kilometres) in a few hands could block interested parties from undertaking reconnaissance. A better arrangement, to encourage basic prospecting, would be to make such licences non-exclusive and perhaps extend their duration to one year.

*Exploration licences* are granted on an exclusive basis for three years with two further extensions of two years each. Surrender requirements of 50 per cent of area only apply in each of the two extension periods.

The holder of a reconnaissance licence may apply for an exploration licence and in turn the holder of an exploration licence may apply for an extraction licence. Several aspects of these processes are below best practice:

- The authorities are given 30 days to approve applications. This is far too short in respect of an application for an *extraction licence* for a major mine, which involves many technical and social issues and the authorities recognize that, in practice, the deadline is not respected.
- Applications for any form of licence must be accompanied by a proposed work programme. This is standard and appropriate for reconnaissance and exploration licences, except that *renewals* of exploration licences should explicitly be subject to satisfactory completion of work programmes to date.
- Read strictly, the law sets no additional preconditions on the grant of an *extraction licence*, except for approval of an environmental impact assessment (EIA). Large mines have many complexities and the grant of extraction licences should also include requirements for submission and approval of:

- Adequate technical and financial capacity of the licence applicant;
- A good-practice mine plan (which among other things sets out the cut off grade to prevent “high grading”);
- A health and safety plan (currently there is only a requirement to submit a safety plan within 12 months of starting operations);
- A community development programme, including local supplier development;<sup>171</sup>
- An employment and skills development plan;
- A reclamation/rehabilitation plan.
- Key commercial rights of investors typically contained in a mining code are not set out, including the right to export, the right of approval of a mining licence if submitted plans are within the law and accepted mining practice and the right to formalize arrangements through a mine development agreement with the State. The latter would set out fully the rights and obligations of the holder of an extraction licence and acceptable procedures for dispute resolution.

Accordingly, it is recommended that the legal regime be revised to improve government controls on these key matters of public interest. It should also clarify or strengthen the areas referred to above of importance to investors. The legal regime for large scale minerals should be separate from the regulation of artisanal mining and of quarrying for industrial minerals. The latter are much simpler ventures.

It should be acknowledged that the 1997 law was an achievement in replacing a highly restrictive law which had been unsuccessful in attracting investment to Guatemala. Nevertheless, it now needs modernization.

The existing light regulation of exploration and extraction has not given MEM the requirement or opportunity to develop appropriate technical capacity to regulate the industry. Indeed, the environmental legislation rather than the mining law is the prominent legal instrument for obtaining and assessing technical data for proposed mines. Modernization of the legal regime will have to go hand in hand with strengthening the role and capacity of MEM.

#### b. Fiscal regime

Revenue for Government is the single most important contribution of mining to development. Thus, the fiscal regime should ensure that the Government takes an adequate share of revenues. At the same time the fiscal regime should be internationally competitive and take into account both that mining is capital intensive and that metal prices fluctuate in wide cycles.

The Guatemala fiscal regime for mining has a usual range of royalties and taxes but these are not well-applied. Current royalty rates of 1 per cent for base and precious metals are extremely low and are also tax deductible. The general corporate tax regime applies to mining but, as seen in chapter II, this regime enables the investor to opt to be taxed at 31 per cent of net taxable income or 5 per cent of gross revenues. The net income regime contains no provision for carry forward of losses after the first year which is a serious handicap since mines inevitably have tax losses arising from high capital expenditure at the construction stage. Yet the 5 per cent of gross revenue option is a flat tax unrelated to profitability. It can hurt low margin operations (such as base metals mines) when prices are cyclically low but also does not provide a progressive public share of mine revenues for exceptionally good deposits.

In short, the conclusion of the taxation section of chapter II also applies to mining, insofar as the current fiscal regime of Guatemala provides neither an adequate share of revenue for Government nor is properly addressed to the requirements of large scale mining investors. It needs comprehensive and urgent reform. It is recommended that changes be undertaken in a three part *package* of measures:

<sup>171</sup> See 2.4 below “Social issues”.

1. Royalties should be increased to 3 per cent on base metals sales value and 5 per cent on precious metals sales value (and made non-tax deductible in line with the most common international practice). The current royalty rates are far too low. It is acknowledged that leading mining countries in Latin America have traditionally imposed very low royalties. But this is changing, e.g. in Chile and Peru. Some proposals have been made to raise royalties to 10 per cent or beyond. However, royalties are a flat charge on revenues irrespective of profitability and thus if too high, will damage profitability when mineral prices are low.<sup>172</sup> MEM has proposed that gold royalties start at 3 per cent and rise to a marginal rate of 7 per cent when gold prices are high. This is also a reasonable approach.
2. Corporate income tax needs to be restructured, in particular to allow loss carry-forward and improved depreciation provisions, including accelerated depreciation. These changes would facilitate early cash flow for the investor to pay down debt. Mining projects are very capital intensive and debt is often 75 per cent of project development expenditure. On the other hand, applying a conventional corporate income tax enables the Government to share better in revenues when metal prices and profits are high. In line with the recommendation of chapter II, the option to pay 5 per cent tax on gross revenues should be removed.
3. Companies with existing extraction licences should be given a 10-year fiscal stability guarantee on the new fiscal arrangements. This will give investors confidence that the new fiscal terms will not be subject to repeated changes. Both Chile and Peru routinely offer contractual stability of certain key fiscal terms for large scale investments, including in mining. Table III.9 summarizes the changes that are recommended.

**Table III.9. Recommended changes to the fiscal regime for mining in Guatemala**

Item	Current	Recommended
<b>A. Royalty</b>	1%; tax deductible	3% base metals, 5% precious metals; non-deductible
<b>B. Income tax (ISR)</b>		
Rate on profits	31%	Retain
Optional tax	5% of revenues	Remove option
Dividends	0% residents; 10% non-resident from untaxed profits	Retain
Amortization & depreciation (% p.a.)	- Exploration: 20	Flexible
	- Mine development: 10*	20
	- Buildings: 5	20
	- Furniture & equipment: 20	Retain
	- Vehicles: 20	Retain
	- Computers: 33.3	Retain
	- Acceleration: none	Accelerate for first 3 years of operations up to zero taxable income
Thin capitalization rule (***)	None	Introduce
Loss carry forward	Not available after year 2	5 years continuous
Project basis	No ring fencing(**)	Ring fence each project(**)
Other taxes	Net asset tax, stamp duty on dividends etc.	To be reviewed
<b>C. Stability</b>	None	Contractual guarantee of no change in tax rates or base, no new taxes for 10 years

(\*) Assumed to be covered by the “other” category of depreciation in the tax law.

(\*\*) Ring fencing means that each project is assessed separately for taxation and not grouped at the company level if one investor owns more than one project.

(\*\*\*) A restriction on the amount of capital expenditure that may be funded by debt (since interest is tax deductible). Typical project gearing is 25 per cent equity and 75 per cent debt.

<sup>172</sup> Some proposals of high royalty rates envisage a sliding scale based on metals prices and so incorporate an element of capacity to pay. However, metals prices are not an exactly correlated with capacity to pay which also varies between mines depending on the quality of the deposit. A sliding scale based on after-tax return on investment could be considered (as often occurs in oil extraction) but can be contentious to establish and requires much more sophisticated monitoring than a simple royalty on revenue. It also requires each project owned by an investor to be taxed separately (i.e. “ring fenced”).

It is understood that any Guatemalan company may elect to move from the 5 per cent regime to the 31 per cent regime. If so, it is able to claim depreciation allowances on all assets as if they were new, thus further delaying tax payments. This benefit should be removed in the transitional provisions for the new regime proposed above. When a company now paying a 5 per cent tax on gross revenues is switched to the 31 per cent regime its assets should in future be depreciated at written down value as if the proposed new arrangements had applied from the time the assets had first been brought into use.

c. *Environmental regime*

Reconnaissance and exploration licence applicants must present an environmental mitigation study. Extraction licence applicants must present a full EIA to the Ministry of Environment (MARN) and to the National Council of Protected Areas if mining is to be in a protected area. It was not until 2001 that a regulation (GA 176-2001) made it clear that approval of the EIA is required before an extraction licence can be issued.

National environmental standards have not been fully developed but international standards are available as guidance. There is a view that the Ministry of Environment does not have the technical capacity or the resources (for example it has no laboratory) to adequately assess EIAs or to monitor compliance. It was also claimed that it has been denied entry to one mining establishment. These claims are denied by MARN.

Environmental issues have been at the forefront of community protests at mining and quarrying sites (see section d. below). In response to these pressures MARN could become risk averse and find it easier to decline applications than approve them. There is also a view that in the absence of fully developed national standards MARN may impose arbitrary standards on mining companies (CIEN, 2009).

d. *Social issues*

Exploration and mining activities have generated a series of controversies with local communities, especially indigenous communities.<sup>173</sup> Contentious matters include the extent to which the communities are informed and consulted about potential impacts including on their access to land and water and effects on health. Mining companies are concerned about encroachment of people on mine property. Some disputes have led to violence and destruction of property. For example, Guatemalan Nickel Company (CGN) reports persistent land encroachment and disrespect of its community initiatives (for example its public hospital has been burned down).

A Special National Congressional Commission on Transparency has investigated these issues at three projects including the Marlin gold mine operated by Montana Exploration, a local affiliate of Goldcorp. The Commission report (Congress of Guatemala Republic, 2009) concluded that there was insufficient government testing and verification of analyzes presented by the investor on issues such as the effect, if any, of mine tailings on water reservoirs used by the communities, the integrity of the tailings dam to earthquake damage and the impact, if any, of mine blasting on housing. The report called for more government action to ascertain the true effects of mining and to properly inform communities of the results. MARN believes that its testing programme is adequate.

In a context of a weak presence of government officials, non-government organizations have been active. The Pastoral Commission on Peace and Ecology of the Catholic Church (COPAE) has commissioned its own studies (COPAE 2008, 2009) which conclude that there is evidence of metals and other contaminants in excess of international standards in nearby water supplies and that blasting has caused structural damage to houses. COPAE is adamant that communities such as those in San Marcos where the Marlin mine is located

<sup>173</sup> It is important to note that Guatemala subscribes to ILO Convention 169 which requires community consultations and respect for tribal and indigenous cultural traditions.



### Box III.7. How the EMPRETEC centre in Guatemala helps alleviate poverty

More than 3'500 entrepreneurs, largely indigenous, have already benefited from 98 Entrepreneurship training workshops (ETWs) and business development services offered by the EMPRETEC centre in Guatemala since 2001.

Hosted by the “Asociación de Gerentes de Guatemala” (AGG), the Empretec centre supports the development and success of micro, small and medium enterprises through training and other business development services. With a view to address the specific needs of entrepreneurs from rural indigenous communities, with 24 different Mayan languages, Garifuna and Xinca are also spoken, AGG has adapted the Empretec methodology, taking into account that small business owners cannot afford to take long time away from their businesses. Furthermore, didactical materials and Mayan translators have been used to execute the training workshops to indigenous population.

EMPRETEC Guatemala has also developed several projects geared specially for women such as “Mujer Emprendedora”. Thanks to this project, 90 per cent of participants with established micro businesses saw their profits and sales increase. Another 77 per cent of participants who did not have a business were able to start one within six months of taking the course. “Emprendedor Juvenil”, yet another innovative programme introduced by the EMPRETEC centre in Guatemala, helped 560 students in commercial schools gain an insight into how to run a business. The lack of employment opportunities for youth causes many in this high-risk group to leave the country or fall into bad habits. To prevent this, they were shown how to create their own job opportunities. About 100 business persons who participated in EMPRETEC offered to serve as tutors to help the students create business plans. About five highly successful owners of large businesses offered to speak to the students to serve as role models and show them what could be achieved. A number of students went on to start their own businesses based on the business plans developed during the course, with continued guidance from EMPRETEC. Many will no doubt gain employment more easily as a result of attending the training workshop.

EMPRETEC inspires entrepreneurs in developing countries and countries with economies in transition to start, grow and develop their businesses. The EMPRETEC methodology (developed by David McClelland at Harvard University) identifies 10 personal competencies for successful entrepreneurs:

- Opportunity-seeking and initiative;
- Persistence;
- Fulfilling commitments;
- Demand for efficiency and quality;
- Taking calculated risks;
- Goal-setting;
- Information-seeking;
- Systematic planning and monitoring;
- Persuasion and networking;
- Independence and self-confidence.

Participants in the training workshops develop clear ideas about what they want to do with their businesses in the short and the long term. With these goals in focus, EMPRETEC helps business owners to improve their core behaviours; this influences the operation, and, above all, the results of their businesses. Since its creation in 1988, EMPRETEC has successfully trained about 182'000 entrepreneurs worldwide, 30 per cent of whom are women. Currently, UNCTAD counts with 32 EMPRETEC national centres in Africa, Latin America and the Middle East.

Source: UNCTAD ([www.empretec.net](http://www.empretec.net)), Asociación de Gerentes de Guatemala ([www.agg.org.gt](http://www.agg.org.gt)).

do not want mining and should have a veto power. It appears to have taken a position strongly in support of this approach.<sup>174</sup>

Those in the middle ground suggest that a much stronger government presence is needed in the affected communities in order to properly inform and consult them. They believe that the majority are not necessarily opposed to mining under appropriate conditions and safeguards. Different versions of a Law on Consultation to require a better process are being sponsored in Congress and the Government, the local communities and the ILO are working on adopting the implementing regulations to Convention 169. On the investor side, at least one company at the early exploration stage in its licence areas has opened a dialogue and started community projects in order to build relationships.

These community issues are serious and have a major impact on the future of mining in Guatemala. Three recommendations could be considered for adoption in the new Mining Law:

- Positions of “Mining Warden” could be created within the General Directorate of Mining. The task of mining wardens should be ensure that affected communities are fully informed and consulted as to the impact of exploration and mining activities. This should form part of licence application procedures and be a source of continuous liaison between mining companies, the Government and affected communities during exploration and mining. Papua New Guinea has major mines located in indigenous communities and has a front-line system of mining wardens.
- A social impact study, leading to proposed mitigation and community support programmes, should be a mandatory pre-condition of applications for extraction licences. Entrepreneurial development programmes targeted at the indigenous communities, such as EMPRETEC Guatemala (box III.7), could form integral part of the mitigation measures.
- Formal institutions involving the local and national authorities and the companies should be created to administer royalties set aside for affected communities. If royalties are raised to international levels, and continue to be shared 50 per cent with local communities, a very large flow of funds will be generated. High standard programmes and monitoring are needed. This work should be integrated with community-based long-term plans involving municipal authorities and civil society as advocated by SEGEPLAN.<sup>175</sup> Peru’s practices should be studied in this regard.
- Review whether it is desirable for holders of extraction licences to buy land title in the mining area. This has led to perceptions by former owners that they have been cheated of the “real” value of their properties. This may be a misperception in that sale of land does not include sale of minerals in the sub-surface, which belongs to the State. Mines can operate by acquiring rights to use rather than own land and pay lease rentals. This approach, and better information provision to land owners, might help to remove yet another source of friction with local communities. Of course, rights to use should be accompanied by strong contractual provisions guaranteeing secure access rights.

### 3. Recommendations

Judged by its own objectives, this analysis concludes that Guatemala’s mineral policy has been a comprehensive failure in design and execution. It is unsatisfactory both from the standpoint of national development objectives and reasonable expectations of mining investors. In relation to FDI specifically, Guatemala has attracted much less FDI than its mineral potential would indicate. And even this low level of FDI has not contributed adequately to national development due to national policy failings. Government revenues from mining, a key source of minerals contribution to national development, are very low and mine relationships with local communities are controversial and lack effective government presence.

<sup>174</sup> See [www.mining-resistance.org](http://www.mining-resistance.org)

<sup>175</sup> Presidential Secretariat for Planning and Programming.

Many efforts have been made to improve the minerals regime. Attempts to pass a new mining law have stalled in Congress for several years, in part due to lack of agreement on rates of royalties. Meanwhile, an administrative impasse is developing within the government agencies responsible for regulation of mining activities—the current climate does not favour balanced decisions by regulators such as MEM and MARN.

The key need to implement an effective mining strategy is to persist with efforts to put in place the building blocks of legal and fiscal reform and enhanced government capacity. Guatemala is not a major mining destination but could become one and the industry could contribute to development. The principal measures recommended by this review are:

- i) Develop a legal regime for metals exploration and mining that recognizes it as a large-scale and export industry which presents different regulatory and commercial issues from those of quarrying or artisanal extraction of metallic minerals.
- ii) Require that grant of a mining (i.e. extraction) licence be subject to presentation and approval of an appropriate mine development plan. This plan should include a technical mine plan, a health and safety plan, an employment and skills development plan, community development and local business development programmes (based on a formal social impact assessment), a reclamation/rehabilitation plan and an environmental plan. At present, only the latter appears to be a legal requirement.
- iii) 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. These rights need greater legal visibility and to be enshrined in comprehensive mine development agreements giving contractual certainty to investors' rights and obligations and legal remedies.
- iv) Increase royalty rates and reform corporate taxation to improve government revenue with associated transitional and stability provisions (see detailed recommendations above).
- v) Create positions in MEM of mining warden, tasked to handle liaison between miners, local communities and government agencies. Create more formal vehicles to administer community development programmes with royalty set-asides. These can be part of developing regulations to implement the ILO Convention 169.
- vi) Devote a guaranteed share of increased mining royalties to boosting the staff and capabilities of MEM and MARN to oversee the industry.

#### D. Implications for FDI promotion

The lead agency for investment promotion in Guatemala is “Invest in Guatemala” as discussed in chapter II of this report. Although very dynamic, Invest in Guatemala is a small agency by all standards. At the time of UNCTAD’s fact-finding mission, its staff totalled four professionals and several administrative support staff. At its peak, the total professional staff reached 14. The objectives of the agency are ambitious, with most functions typical of a modern investment promotion agency (IPA), including investment facilitation, research and analysis, marketing, investor targeting, aftercare, as well as advocacy. Given its size, however, the agency is often stretched in delivering on its mandate.

Other public and private sector institutions also carry out investment promotion in Guatemala, both at country-wide level, and with respect to specific sectors. These include the Ministry of Tourism, through InGuat; the commercial attaché programme for investment and tourism (PACIT); the Ministry of Economy through a programme sponsored by the European Union aimed at “Improving Guatemala’s Position in International Markets” (FOGUAMI) and the organization of missions and fairs and the Free Zones association.

As mentioned in chapter II, a reform supported by the Inter-American Development Bank is ongoing and should change the institutional setting for investment promotion in Guatemala. The aim is to consolidate all promotional functions related to both trade and investment under a single new agency, the “Guatemala Trade and Investment” or GTI.

Although UNCTAD has developed a large expertise in the area of investment promotion, a full review of the proposed agency’s functions and structure is beyond the scope of this report and might, if so requested by the Guatemalan authorities, be the object of a follow-up technical assistance to this report. It is however important, in setting up the new IPA, to reflect on a number of investment promotion implications for successful attraction of investment to the three sectors analyzed in this chapter. The new IPA, be it a strengthened Invest in Guatemala, or the GTI, would have an important role to play for the promotion of FDI in each of the priority sectors, as described below.

## I. Energy

FDI has already played and will likely continue to play a crucial role in the development of Guatemala’s electricity sector. Indeed, the implementation of the current and future electricity plans discussed earlier in this chapter is strictly dependent on financial resources and know-how/knowledge that cannot be found either within the State, or in the limited capability of domestic investors. For this reason, this report recommends to develop a comprehensive policy for the sector, which would clearly address investors’ concerns and envisage the improvement of the sector’s policy and institutional framework. As discussed, any such policy would assign an explicit role to FDI and set adequate targets associated to its attraction.

Developing an FDI promotion campaign is therefore a priority. The first step in devising an FDI promotion campaign is to clarify which among the objectives of the electricity expansion plan are to be achieved through foreign investment and to create a master plan of projects eligible for investment attraction. In this regard, MEM should take the lead but the IPA should support MEM’s efforts as follows:

- a) *Project preparation.* The IPA should support MEM’s efforts to secure funding to prepare such a plan.
- b) *Marketing and promotion.* The marketing and active promotion of the portfolio could be delegated to a joint MEM-IPA team. The communication effort should collect and harmonize all the information required for investment in the sector that is currently dispersed in various government agencies (e.g. MEM and MARN). As part of this effort, guidelines for investors should be prepared and published on a website dedicated only to the electricity sector, its dynamics, and projects. The dedicated MEM-IPA team would solicit contacts with potential investors through energy fairs and forums;
- c) *Facilitation.* The joint MEM-IPA team would also provide a single interface for all investors interested in the electricity sector and facilitate all necessary contact with other agencies of the public administration.

## 2. Roads

It is premature for the IPA to actively market Guatemala’s concession projects and it would be counterproductive to do so.<sup>176</sup> There is no credible list of projects and the new policy and institutional framework of ANADIE has yet to be established.

Invest in Guatemala and PRONACOM have so far contributed to move forward the idea of road concessions. They sponsored the multimodal transport study of 2007 and have assisted in the preparatory

<sup>176</sup> At least one Invest in Guatemala document lists toll road projects even though they are not fully prepared and there is no government commitment to them.

work for the new concessions law. The new agency could undertake valuable work, once the new law will have been adopted, in the following areas:

- a) *Project preparation.* Similar to what recommended in electricity, the IPA should support MCIV's efforts to secure funding to prepare a pipeline of projects for concessioning.
- b) *Market research.* The IPA should build up profiles of emerging foreign investors in the region (by type, as per section B.2 above). Research would include fact-finding visits to Latin American countries where toll roads are used and interviews with companies involved. These profiles should ascertain for each investor: 1) the investment capacity in terms of size and technical experience and their ability to bring in finance, notably through joint ventures; 2) their needs and interests in associating with local partners and tapping local debt finance; 3) the interests by size and type of road project and in greenfield projects (rather than acquiring existing operations); and 4) their interests and concerns about investing in Guatemala. This market research should be done in close collaboration with MCIV and the local industry.
- c) *Advocacy.* Where investors identify unnecessary barriers to investing in Guatemala these should form part of the IPA's advocacy programme. For example, Guatemala scores poorly on the PPP Preparedness rankings (tables III.7 and III.8). The IPA should coordinate a programme to identify and improve Guatemala's ratings and promote improvements to foreign investors. For instance, local finance is a vital complement to FDI in concessioning. The IPA should become active in advocating a better policy regime to obtain a deeper and more liquid local capital market.

The above three activities are all important preparatory steps. Guatemala is not yet in a position to solicit investment in road concessions. This will take at least three years. Done well, the above actions will significantly improve the timeliness of project delivery and the range of foreign investor interest in competing for toll road investments in Guatemala.

### 3. Mining

Guatemala is known to have high mineral potential. The greatest need identified in this report to tap this potential is to remove policy barriers rather than to carry out an active marketing campaign to solicit investor interest. Guatemala has already attracted one major mining company, Goldcorp, the second largest North American gold miner. Goldcorp has persisted in expanding investment. BHP Billiton, the world's largest mining company, was also attracted but recently sold out its portfolio of exploration interests to a junior miner. Most mining jurisdictions would be delighted to attract the world's largest company and would work hard to sustain its interest. However, the policy barriers have demoted Guatemala to the status of junior miner territory.

Accordingly, rather than marketing, the key short-term tasks of the IPA should be to work with MEM on:

- a) *Advocacy.* The IPA should continue its advocacy to have a revised Mining Law and better fiscal arrangements adopted including recommendations from this report.<sup>177</sup> It should also join a concerted effort within Government to ensure that the Phoenix nickel project is implemented on terms that are beneficial to the country, the local community and the investor. These two matters are the key tests of a turnaround in the investment climate for mining. They are likely to take two years to implement.
- b) *Linkages.* During this period, a strengthened IPA could also assist by offering to host a linkages programme to foster supplier development to mines. It could also offer facilitation services to existing miners especially any new junior entrants.

<sup>177</sup> PRONACOM, the sister agency of Invest in Guatemala, in charge of fostering the overall competitiveness of the country was already a member of the 2008 Technical Commission established by Congress to review the proposed new law on mining.

Once these two key tests are achieved, Guatemala's IPA could proceed onto a second phase and take on more of a marketing and strategic role:

- a) *Awareness raising.* The IPA would assist MEM to re-launch Guatemala as a world class mining destination. This includes the image creation aspects of a country re-launch programme seeking to revive international investment. It would aim to attract new investors and to assist existing juniors to farm-in larger investors.
- b) *Research and sustainability.* The agency would prepare jointly with MEM a strategy paper on needs for long-term development of skills, local supplier opportunities and attracting FDI to downstream processing business.

## IV. CONCLUSIONS AND RECOMMENDATIONS

Over the last two decades, economic policy in Guatemala has focused on three main axes: 1) reducing debt and restoring macroeconomic stability, compromised by the long civil conflict; 2) opening access to new markets; and 3) liberalizing the economy and fostering private investment, national and foreign alike, particularly in utilities and infrastructure. Although they have failed to achieve the primary objective of lifting the majority of the population out of poverty, these policies have nevertheless borne some fruits. Guatemala is now one of the countries with the lowest debt to GDP ratio in Latin America and exports have grown beyond traditional sectors and into new markets. Also, Guatemala's performance in attracting FDI over the last decade has been the best in its history.

The investment has had a beneficial impact on employment, wages, exports and the quality of electricity and telecommunications services. Nonetheless, Guatemala has so far attracted relatively low levels of FDI, judged both against the performance of other countries in the region and 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. In brief, Guatemala can legitimately aspire to become a manufacturing and services hub for Central America.

Holding investment back are the significant challenges that persist on the social and economic fronts. Income inequality and violence plague social life, reduce the effective market size and hamper economic growth. The Government has committed to address these challenges but often lacks the necessary institutional capacity, with dire consequences on policy implementation and on the provision of key public services such as education, health and security. Although many public institutions have been strengthened in recent years through the adoption of information technology, the persisting weakness of key regulatory agencies hampers the achievement of government objectives and the protection of public interest in strategic sectors. These include sectors explicitly targeted for FDI, such as electricity, mining and road infrastructure, which are the strategic focus of this report. In addition, business competitiveness is held back in certain areas by overly bureaucratic and costly administrative processes.

Continued regional integration through infrastructure (roads, telecommunications and electricity networks) and trade is opening new investment opportunities for Guatemala, both in manufacturing and services. The country can attract much higher levels of FDI and also extract increased development benefits from it, including through an injection of competition into the domestic industry and services, a greater contribution to much needed revenue generation and improved cost and quality of key infrastructure. These are all attainable goals, which require policy responses from the Government. This report articulates a number of recommendations to help shape these responses by improving the regulatory framework and strengthening the sector-specific FDI policies. Against this background, the main recommendations are summarized around two strategic elements: a) Improving the general investment framework; and b) Attracting FDI to priority sectors - electricity, mining and roads.

### A. Improving the general investment framework

#### I. The fiscal regime

The corporate tax regime gives taxpayers the possibility to choose between a flat tax of 5 per cent on gross income (general regime) or a corporate tax of 31 per cent on net income (optional regime), regardless of sector of operation, profit margin or income levels. The general regime has been an important simplification measure, which is typically aimed at small companies. It is however used by the majority of large companies, including in services, and has become excessively costly in terms of lost tax revenues.

As it stands, it favours tax engineering, arbitrage and evasion, discourages start-ups and fails to produce sufficient revenue to provide essential public services and address the social needs of the majority of the population. In this regard, the tax policy needs to be re-oriented to better serve the country's development and investment objectives. In particular, the IPR recommends an integral package of measures aimed at restructuring corporate taxation by:

- Making the current optional regime the standard corporate tax regime and improving its competitiveness by: introducing accelerated depreciation to facilitate company formation and development; and progressively reducing its rate to 25 per cent;
- Limiting the scope of application of the current general regime by sector, so as to exclude services and extractive industries; or by turnover, so as to target it to SMEs;
- Allowing companies to opt for a different tax regime only once every five years;
- Strengthening the supervisory and sanctioning powers of the SAT in dealing with tax evasion.

The report also recommends:

- In mining, where insufficient tax revenue is extracted, to increase royalty rates to 3 per cent on base metals and 5 per cent on precious metals; to remove the option to pay 5 per cent on gross income and to apply the improved corporate taxation regime; another viable option is to let gold royalties start at 3 per cent and allow them rise to a marginal rate of 7 per cent when gold prices are high;
- To review the effectiveness of the current incentive schemes for maquila and export activities and urgently address the need to ensure their compliance with the WTO requirements;
- To introduce rules to regulate transfer-pricing in accordance with international standards;
- To negotiate and ratify double taxation treaties with the main existing or potential source countries of FDI in order to avoid double taxation of profits.

## 2. The institutional capacity of key government agencies

The reforms adopted since the mid-1990s have generally introduced modern legislation and policies, which have complemented an already liberal investment regime. The privatization of key utilities and the laws on foreign exchange, environment and intellectual property are recent examples. Gaps remain, however, in the regulatory and institutional arrangements necessary to ensure an appropriate oversight of the market. Moreover, institutional weakness puts at risk the delivery of important public services, including the protection of public interest by key regulatory agencies.

In this regard, the IPR recommends strengthening the public sector's institutional capacity and allocating more public resources in areas such as:

- **Investment policy:** the institutions in charge of the design and implementation of investment policy are weak and the capacity to respond to and prevent disputes between foreign investors and the State should be improved. To this end, dispute alert and prevention mechanisms should be introduced and better coordination is needed in activating dispute resolution mechanisms when necessary.
- **Competition:** Guatemala has an important competition problem; unfair business practices are an obstacle to company development, they undermine the effectiveness of liberalization measures and encourage inefficiencies and market distortions. Adopting a competition law and policy, overseen by an autonomous agency should be a priority of the development agenda. Sector-specific pro-competition measures are also needed (see section B below).



- Sector regulators: the agencies regulating key sectors and utilities, such as energy, mining and roads, need significant strengthening, as further detailed below.
- Judiciary: the lack of efficiency of the judicial system, routinely rated as among the slowest in the world, is not limited to the criminal field, where violence constitutes a significant deterrent to investment. It extends to commercial justice, which is the slowest in the region. A key problem in this regard is the lack of specialized tribunals in areas such as commercial justice or land. Although some progress has been observed in the modernization of the judiciary, alternative dispute resolution mechanisms should be further explored, as well as the establishment of specialized commercial and land tribunals.
- Environment: the institutional weakness of the environmental agency is recognized by the authorities. A strengthening of its monitoring and evaluation capacity is urgent, as it bears many implications on the social, economic and environmental development of the country. This includes ensuring the sustainable development of the energy, mining and infrastructure sectors prioritized by the Government.
- Intellectual property: capacity-building and better coordination is needed among the authorities in charge of IP policy and enforcement, including the police, customs, judicial authorities and intellectual property register. Campaigns to train IP societies and right holders on how to enforce their IP rights and encourage a culture of respect of IP rights should be coordinated with the support of the private sector.

### 3. Red tape and administrative efficiency

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 the 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 analysis presented in this report leads to the following recommendations:

- Company registration: the process should be reformed in order to remove unnecessary steps and duplications. In this respect, it is recommended to introduce a single electronic registration form, eliminate the need to notarize documents and consolidate all relevant fees and taxes in one single payment. Fiscal stamps should be abandoned.
- Entry of foreign labour: the regime should foster the attraction of skills that are lacking in Guatemala and the diffusion of the relevant know-how to the local workforce. To this end, the current labour market testing and the cumbersome permitting procedure should be replaced with an active skills attraction programme based on a “scarce skills list”, in line with good international practice. A skills dissemination scheme, whereby companies hiring foreign workers increase their contribution to INTECAP from the payroll levy from 1 to 2 per cent could also be introduced, as well as skills exchange programmes.
- Access to secure land title: cadastral measurement and the identification of land rights should be continued to provide clear ownership titles to those in rightful possession of land. Perceived complexity in procedures and high costs are disincentives to formalize land rights. In this respect, the adverse possession procedures, currently long, complicated and expensive, should be streamlined. The poor should receive legal and technical assistance to adequately fulfil these requirements. Also, the mandatory registration of new land rights with the RGP should be introduced and supported by adequate sanctions.

## B. Attracting FDI to priority sectors - electricity, mining and roads

Out of the three sectors explicitly targeted by the Government, electricity has been the most successful in attracting FDI. Investment has increased capacity and limited shortages in the recent past. Electrification coverage has also increased at a faster pace, including in remote rural areas. The main drawback has been price increases driven by several factors including the high reliance on fossil fuels. Mining has attracted some FDI, but additional investment faces strong resistance from local communities, which are concerned about damages to their land and the environment and are unsatisfied about the compensatory mechanisms put in place to share the benefits of mining. Very little FDI has been directed towards the road infrastructure thus far, pointing to the fact that FDI in this sector is at an experimental phase. However, a draft public-private partnership (PPP) law may pave the way to new private investment in this sector. The Government has set ambitious objectives to attract increased levels of FDI in these three sectors. The analysis contained in this report points to the following recommendations.

### I. Policy development

The three sectors are at different stages of policy development. In electricity, for instance, modern legislation has been adopted and several planning documents have been prepared to address specific issues in generation, transmission and distribution. There is, however, no comprehensive energy policy. In mining, the current legal and regulatory framework does not provide adequate protection of the public interest with respect to generating sufficient revenue for the Government, adequately protecting the environment and local communities and providing an internationally attractive investment regime. In roads, the draft concessions law is good, but the policy needs testing and fine-tuning and the sector institutions need further capacity-building before any significant FDI can be attracted.

- **Electricity:** a national energy policy should be developed to address in an integrated manner issues related to security of supply, efficiency, affordability and environmental sustainability. The policy should include the definition of a generation master plan and it would enlarge the investment offer by clearly defining and communicating the Government's priorities in the medium and long run, including with respect to FDI. Minimum environmental standards, incentives for green and smart technologies, infrastructure modernization objectives and a portfolio of electrification projects would also be essential components of the comprehensive policy;
- **Mining:** a new legal regime that recognizes metals exploration and mining as a large-scale and export industry should be developed. Among the key legal changes recommended is to demand an appropriate mine development plan as a prerequisite for granting an extraction licence. This plan would include, in addition to the environmental impact study, a social impact study (see below), a health and safety plan as well as a reclamation/rehabilitation plan. Furthermore, renewals of exploration licences would be explicitly subject to satisfactory completion of the work programme required by the plan. The new regime would also introduce guarantees for investors (including the right to export, to retain sale proceeds in foreign currency and to convert an exploration licence to a mining licence upon approval of the mine development plan); and, as already discussed, a reform of the fiscal regime applicable to the sector to increase fiscal revenue (see the fiscal regime above);
- **Roads:** the draft concessions law should be complemented by a substantial project pipeline of well-researched high priority projects for investment attraction. The law itself should be revised to allow for concessioning of existing roads, under specific tolling and service improvement criteria. Moreover, the current control provisions of the law, based on the principal-client relationship typical of the public works projects, should be revised to ensure that both parties to the concession contract accept performance obligations, as is standard in PPPs.

## 2. Participation of local communities

An increased involvement of local communities in the decision-making process related to investments localization is necessary for the development of any of the priority sectors. Adequate consultation mechanisms should be pursued before embarking on any new sensitive venture. Also, local communities should better share in the benefits associated with the different projects in the three sectors. In this regard:

- The regulations necessary to implement ILO Convention 169 should be adopted;
- A social impact study, covering community development needs, employment and skills generation, and local business development should accompany the technical and environmental impact studies in the mining sector, and in the other sectors where deemed necessary;
- A law regulating the usage of water as a natural resource and public good should be introduced, under which a royalty payment to the State should be foreseen and partly channeled to local communities;
- Positions of mining wardens could be created within MEM to ensure that affected communities are fully and systematically informed and consulted as to the impact of exploration and mining activities.

## 3. Sector regulators

FDI attraction requires investors' trust in the authorities' impartiality and competence. Actions suggesting arbitrariness in the enforcement of rules or lack of relevant technical skills by the sectoral authorities and regulators can be severely detrimental to the investment climate. Thus, MEM, MARN and the key regulatory agencies should be empowered with the resources necessary to carry out their functions. In addition:

- An institutional capacity-building plan preparing MEM (and MARN) to deal with arising issues related to grid innovations and renewable energies is necessary;
- The modernization of the mining legislation will have to go hand in hand with strengthening the role and technical capacity of MEM to regulate the industry;
- A guaranteed share of increased mining royalties should be devoted to boosting the staff and capabilities of MEM and MARN to oversee the mining industry;
- MCIV should be supported to commission the detailed technical, financial, environmental and social studies required to prepare a sound pipeline of projects for FDI attraction. MCIV and ANADIE should be assisted to develop the expertise needed to decide which roads are suitable for concessioning and ANADIE should be empowered to review the terms of all significant concession contracts, including those implemented by agencies and municipalities under the 1992 state contracts law.

## 4. Sectoral threats to competition and price distortions

As part of the recommended strengthening of the competition regime, the following sectoral issues should be addressed:

- There is a clear lack of competition in the supply of materials for the construction sector and steps should be taken to ensure that it does not lead to non-competitive bidding for road concessions. In this respect, a register of approved suppliers who undertake to quote the same terms to all bidders and only accept bids from consortia whose suppliers are also certified should be established and imported building materials should be allowed duty free entry.

- Some threats to competition are emerging in the electricity market, which could lead to price manipulation and abuse of market power. At present, investors who own both hydro and thermal generation plants are presented with a moral hazard situation whereby they would benefit from suspending the dispatch of cheap hydro energy for that of thermal energy to drive prices up in the spot market. In this regard, unbundling hydro from thermal generation would avoid possible market abuses.
- The current social tariff scheme for electricity distorts the market price, is abused by users and is not sustainable. Its application should be limited to the population living in poverty. This would also help improve the financial viability of INDE. Alternatively, the tariff scheme could be removed and substituted with a social support paid to the low income families by the central Government or the municipalities (and not by INDE), and/or compensating the related loss of revenues with minimal surcharges to the remaining users and/or generators.

## 5. FDI promotion

A properly structured and resourced investment promotion agency can support the FDI attraction effort in the three priority sectors in a number of ways, including:

- a) *Project preparation and research.* The IPA should support the line ministries and institutions in preparing a pipeline of projects for concessioning or investor targeting. In roads, the IPA should build up profiles of emerging foreign investors in the region in collaboration with MCIV and the local industry. In mining, the agency should prepare in conjunction with MEM a strategy paper on needs for long-term development of skills, local supplier opportunities and attracting FDI to downstream processing business.
- b) *Marketing and promotion.* The marketing and active promotion of the project portfolios in the three sectors could be delegated to joint teams composed of staff from the IPA and the relevant ministries. The communication effort should collect and harmonize all the information required for investment in the sectors and the dedicated teams would solicit contacts with potential investors through sectoral fairs and forums;
- c) *Facilitation.* The joint teams would also provide a single interface for all investors interested in each of the three sectors and facilitate all necessary contact with other agencies of the public administration.
- d) *Advocacy.* Where investors identify unnecessary barriers to investing in Guatemala these should form part of the IPA's advocacy programme for the three sectors. In mining, for instance, the IPA should continue its advocacy to have a revised Mining Law and better fiscal arrangements adopted including, if appropriate, recommendations adopted from this report. It should also join a concerted effort within Government to ensure that the Phoenix nickel project is implemented on terms that are mutually beneficial to the country and the investor. Other concrete examples are offered in chapter III.
- e) *Linkages support.* A strengthened IPA could also assist by offering to host a linkages programme to foster supplier development programmes, much needed to expand the benefits from FDI to the local economy. In mining, in particular, it could also offer facilitation services to existing companies, especially any new junior entrants.

## C. Summary of key recommendations

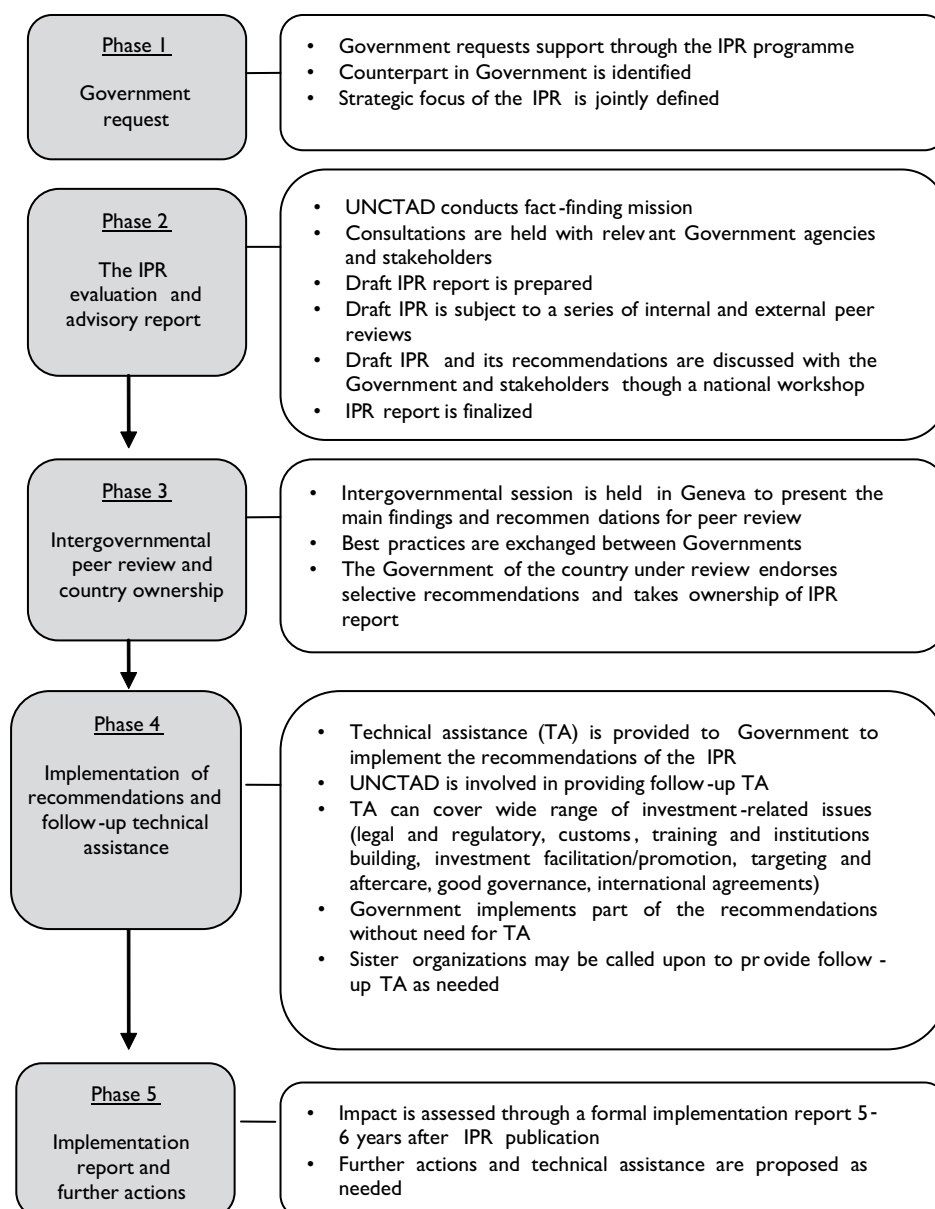
The table below contains a summary of the key recommendations of this report, as well as indications regarding UNCTAD's assessment of their respective priority (high, medium and low) and time required for implementation. More details on each recommendation are provided in the relevant sections of this report.

Policy area	Main recommendations	Priority	Implementation
FDI-specific measures	- Revise the methodology for FDI data collection	high	<1 year
	- Revise the Foreign Investment Law and remove inconsistencies with other laws	low	
	- Adopt a model BIT and renegotiate existing BITs containing unclear or inconsistent provisions	medium	1 to 3 years
	- Establish coordination mechanisms to negotiate BITs, prevent investor-State disputes and defend the State in case of dispute	high	
	- Formalize the new legal and institutional arrangements for investment promotion	high	<1 year
Company establishment	- Streamline the commercial registration process - Consolidate fees and taxes in one payment - Remove fiscal stamps and reduce notary involvement	medium	<1 year
Taxation	- Restructure corporate income taxation to reduce scope for evasion and increase fiscal revenues; - Strengthen the supervisory and sanctioning powers of the fiscal authorities - Review the effectiveness of the incentive schemes and ensure future WTO compliance	high	1 to 3 years
Skills and employment of foreigners	- Revise the permanent residence provisions and introduce a business talent attraction scheme - Replace the labour market testing with an active skills attraction programme based on a scarce skills list - Implement a skills dissemination scheme through INTECAP	medium	1 to 3 years
Land	- Complete cadastral measurement and land rights identification - Introduce the mandatory registration of new land rights, supported by adequate sanctions - Create special agrarian tribunals to solve land conflicts	high	3 to 5 years
Commercial justice	- Introduce specialized commercial tribunals - Review the judges' rotation system - Foster the use of ADR mechanisms	high	1 to 3 years
Competition policy	- Adopt a competition policy and law - Establish a competition agency	high	1 to 3 years
Environment	- Strengthen the institutional and financial capacity of MARN	high	< 1 year
Intellectual property	- Complete CAFTA implementation - Build capacity of public officers (police, judges) - Improve IP enforcement coordination	low	< 1 year
Mining	- Develop a new legal regime that: * subjects the mining licence to a mine development plan (including social, technical, environmental assessment, community development and rehabilitation plans); * recognizes the right to export and the rights to convert sale proceeds in foreign currency and exploration into mining licence; * increases royalty rates and reforms corporate taxation to improve government revenue; * devotes a share of increased royalties to boost staff and capacity of MEM and MARN; * creates "mining wardens" to handle liaisons between firms, communities and government;	high	< 1 year

Policy area	Main recommendations	Priority	Implementation
Electricity	<ul style="list-style-type: none"> <li>- Develop a comprehensive energy policy through a public and participative process;</li> <li>- Enhance investment protection and participation by local communities (adopt regulations to ILO 169, law on use of water; local community tax on power producers);</li> <li>- Reduce the electricity subsidy threshold to users of &lt; 50kWh;</li> <li>- Release INDE from the subsidy-related obligations and increase its commercial focus;</li> <li>- Introduce minimum environmental standards based on the “best available technology”;</li> <li>- Develop appropriate “green” incentives for renewable energies;</li> <li>- Adopt a “smart grid” to accommodate new types of generation which are variable and non-programmable;</li> <li>- Continue the electricity coverage expansion programme.</li> </ul>	medium	1 to 3 years
Roads infrastructure	<ul style="list-style-type: none"> <li>- Establish a substantial “project pipeline”;</li> <li>- Increase funding for ANADIE;</li> <li>- Allow concession of existing roads under specific conditions;</li> <li>- Adjust the control provisions of the law by requiring parties to appoint an Independent Project Certifier;</li> <li>- Assign political “champions” to ensure project delivery;</li> <li>- Let ANADIE review all significant concession contracts, including those under the State contracts law;</li> <li>- Sustain capital market development through mutual and pension funds;</li> <li>- Ensure competitive biddings in respect to supply of materials;</li> </ul>	medium	1 to 3 years

## ANNEX. IPRs - AN INTEGRATED ASSISTANCE APPROACH

The IPR is a comprehensive, demand-driven and country-specific process of technical assistance which spans over a medium- to long-term horizon. The programme starts with preparation of the IPR report and policy advice, continues with support for putting the recommendations into action and follows on with a formal implementation report with proposed further actions. Below is a schematic presentation of the IPR approach.



For more information on the IPR process and framework, please visit:

[www.unctad.org/ipr](http://www.unctad.org/ipr)





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UNCTAD, Incentives and Foreign Direct Investment (New York and Geneva, 1996). Current Studies, Series A, No. 30. 98 pages. Sales No. E.96.II.A.6. \$25.

UNCTAD, Foreign Direct Investment in the People's Republic of China (New York, 1988). 110 pages. Sales No. E.88.II.A.3. Out of print. Available on microfiche. Paper copy from microfiche: \$122.

UNCTAD, Foreign Direct Investment, Trade, Aid and Migration Current Studies, Series A, No. 29. (A joint publication with the International Organization for Migration, Geneva, 1996). 90 pages. Sales No. E.96M.A.8. \$25.

UNCTAD, Explaining and Forecasting Regional Flows of Foreign Direct Investment (New York, 1993). Current Studies, Series A, No. 26. 58 pages. Sales No. E.94.II.A.5. \$25.

UNCTAD, Small and Medium-sized Transnational Corporations: Role, Impact and Policy Implications (New York and Geneva, 1993). 242 pages. Sales No. E.93.II.A. 15. \$35.

UNCTAD, Small and Medium-sized Transnational Corporations: Executive Summary and Report of the Osaka Conference (Geneva, 1994). 60 pages. Available free of charge.

### C. Journals

Transnational Corporations Journal (formerly The CTC Reporter). Published three times a year. Annual subscription price: \$45; individual issues \$20.

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