



10 calle 3-17 zona 10
Edificio Aseguradora General Nivel 5
Guatemala City, Guatemala
Tel: +(502) 2331-5133
Web: www.fundesa.org.gt
Contact: jczapata@fundesa.org.gt

Guatemala: Country Report

1 Executive Summary

Guatemala's economy is not growing fast enough to provide the requisite jobs or to effectively reduce poverty. In a recent national survey, 80% of respondents who have considered migrating answered that they would do so primarily in search of better economic opportunities.

Economic growth is predicated on the certainty of the business-climate, a key variable to retain existing projects and to attract future investments. That certainty is being threatened by several recent developments including (i) "judicial activism" to suspend projects based on ILO Convention 169, (ii) Proposed constitutional amendments to article 203 diminishing rule-of-law, (iii) heightened land invasion activity backed by drug cartels, and (iv) a recent spike in contraband due to the collapse of the Mexican peso.

USG support of Police Reform, Penitentiary System Reform, and fight against corruption, to name but a few examples, have generated visible impacts in Guatemala. The proposed Alliance for Prosperity Plan has enormous potential to reduce illegal migration. A greater sense of urgency and heightened execution capabilities might be achieved through increased involvement by the private sector. A renewed focus on job-creation would yield the most permanent reductions to migration. Intermediate cities and investments in strategic infrastructure would enable those aspiring for a better future to migrate locally instead of looking north. 44.49% of the gap between the country's current rate of growth and its potential growth rate is caused by poor strategic infrastructure. Draft legislation to create a strategic infrastructure fund has already been drafted.

2 Political Risk and Governance

The ongoing failure of Congress to vote against the reform of article 203 on indigenous jurisdiction in the Constitutional Reform, raises serious concerns for legal certainty in the country, and especially in the fight against drugs. Constitutional lawyers and academics at the Universidad de San Carlos de Guatemala, have expressed serious concerns that the changes to Article 203 of the Constitution undermine legal certainty towards the country's international treaties, especially in those regarding measures to fight drug trafficking and money laundering. The proposed changes also present a great risk towards investment, especially in energy, mining, palm oil and other sectors operating in rural areas with large indigenous communities. This would also present a major challenge for the Plan for the Alliance for

Prosperity for the Northern Triangle of Central America, to generate jobs in the Western Highlands in order to reduce migration to the US.

Alta Verapaz department continues to be a high-risk investment location, due to social conflicts relating to major development projects and a lack of state presence to address drugs trafficking activities. The municipality of Panzos in Alta Verapaz is one the poorest areas in Guatemala, where 85% of the population live under the poverty line. This is exacerbated by the near non-existent presence of state institutions, and the increasing pervasiveness of drug trafficking organizations. These criminal groups exploit local indigenous communities, often by illegally occupying private property and using the attained land for illegal purposes.

Withdrawal of Security Forces has enabled alternatively governed spaces (AGS) and has left businesses vulnerable to violence and occupation. A recent example of this phenomenon is the occupation and destruction of the Naturaceites Palm oil plantation¹, where armed gunmen have occupied the Palestina palm oil plantation in Panzos since late February, blocking off several surrounding highways, and destroyed large swathes of the plantation. It is suspected that the areas are being cleared to create trafficking corridors. Despite publically cries for assistance from law enforcement, and national media coverage, the occupation was able to continue for more than 25 days, during which time the plantations' 200 local workers were unable to reach the site.²

The US Embassy in Guatemala is also aware of the problem and senior officials have stated that they will support the effort to follow up with Guatemalan authorities, as well as with US security and law enforcement agencies.

According to a senior police officer at the National Civil Police, the National Civil Police believes that drug trafficking organizations are arming agricultural workers and instructing them to take control of land located along key trafficking routes, all the while masking their intentions under the guise of "Indigenous Rights". Local police fear confronting these agricultural workers, who are more heavily armed than law enforcement officials themselves, as a result of their links to violent drug traffickers. The government is similarly reluctant to send in National Civil Police or the military for fear of escalating the violence. International pressure has forced the large scale withdrawal of the military from territorial control functions without a commensurate increase in Police personnel or capabilities to fill that void. International human rights organizations have criticized Guatemala during recent government confrontations with indigenous groups. Fears of further criticism are contributing to government reluctance to intervene. It therefore appears unlikely that the rule of law will be reestablished in departments such as Alta Verapaz in the immediate future. This is also the case in many municipalities in the Western Highlands, where investors are reluctant to go, because of the serious lack of rule of law, especially when it comes to the application of the 169 Convention of the International Labour Organization on Indigenous and Tribal People.

¹ <http://republica.gt/2017/03/un-mes-continua-la-impunidad-y-la-invasion-de-finca-palestina/>

² <http://republica.gt/2017/03/finca-palestina-lleva-21-dias-invadida-y-sigue-la-tension/>

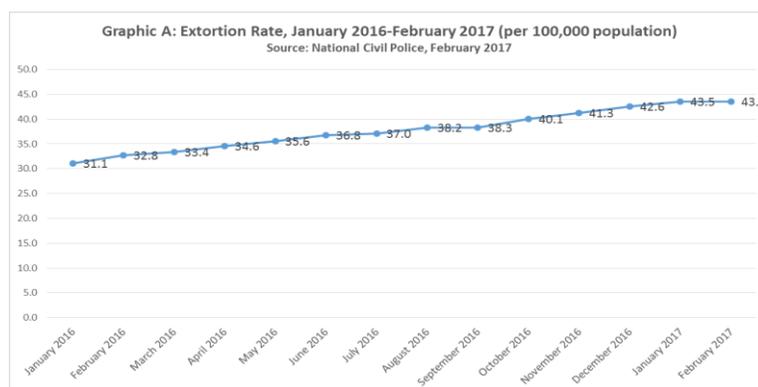
The complexity of the situation outlined by the senior police officer cannot be addressed without a substantial increase in police resources to impose the rule of law in the region. Indeed, even if the US were to significantly focus its resources on Guatemalan regions where drugs traffickers are active, the challenging topography of these regions will also prove to be a limiting factor preventing the imposition of the rule of law, undermining the development of an environment which is conducive to private investment. Recent investments in Police Reform have generated important results but have not yet addressed the creation of Special Forces capable of facing highly-armed enemies in rural terrain.

Though homicide rates continue to decline steadily, the security situation remains a major concern for investors. The Homicide Rate has been steadily reduced from 46 per 100,000 in 2009 to 27 per 100,000 today. However, according to the World Economic Forum's Global Competitiveness Report for 2017, 19.7% of business leaders still believe that crime and theft is the biggest factor affecting the business environment in Guatemala, compared to 26.6% in El Salvador and 13.5% in Honduras. Corruption is cited as the second biggest concern (17.7%) and poor infrastructure (14.1%) as the third most problematic factor. Several high-profile scandals have placed the extent and severity of corruption in Guatemala in the international spotlight. The fact that crime is cited as the most significant business risk in spite of the prominence of corruption highlights how significantly the business environment is affected by crime. The depth of corruption within national and, crucially, local government is itself a major obstacle to improving the security situation as it deprives anti-crime measures of legitimacy and resources. In order to successfully cut violent crime, the government must first address corruption, as current law enforcement bodies are themselves often in cahoots with armed gangs, and frequently involved in the extortion or bribery of government officials.

The government is making some inroads into addressing the crime related risks to business, though it remains to be seen if this will have any long-lasting effect. The National Civil Police has started receiving support from the Citizen Security Coalition, a public-private initiative to reduce crime and violence in the country. The CSC is providing authorities with more information on the location and details of criminal activity affecting businesses.

A high level industrial entrepreneur contacted for this report commented that he has noticed greater co-operation with the National Civil Police since this initiative was launched. The entrepreneur highlighted the Citizen Security Coalition's anonymous crime reporting mechanism, which he believed to be highly useful to police investigations.

According to the latest data, business extortion is growing significantly, undermining local businesses and investor confidence. According to the National Civil Police, Guatemala saw an increase of 21.17% in the number of reported incidents of business extortions, from 595 cases in January 2016 to 721 to January 2017. As Graphic A presents, there has been an increase of 40% in the rate of extortions for every 100,000 people in the past year.



The indictment of a former Vice President and former Interior Minister by a US Federal Court is indicative of continued progress in challenging the government-organized crime nexus. The indictment issued in February provides clear evidence of the Morales Administration's intentions to make good on its election promise to take a more stringent stance on official corruption, and to make use of continued US support in counter-narcotics trafficking.³

The indictments also serve to put on notice other politicians who have engaged in or facilitated drug-trafficking and corrupt practices. As is currently playing out in neighboring Honduras, extradition to the US of key members of the government-organized crime nexus typically results in plea-bargaining. In exchange for a more lenient sentence in the relative safety of the US prison system, witnesses provide detailed information on criminal networks, which are subsequently arrested and disrupted through a combination of law enforcement and military operations. Given the extensive corruption and collusion with drug-traffickers by many members of congress, municipal mayors and provincial politicians, the extradition of Baldetti and López Bonilla is expected to significantly disrupt what analysts have described as Guatemala's parallel 'Mafia State'⁴.

The Morales Administration nominated a highly technical cabinet in an attempt to reduce corrupt practices. The ability of these ministers to root-out highly engrained corrupt practices is still in question. Governance at a municipal level and other autonomous institutions also remains severely undermined by corruption. Moreover, corruption is rampant in less prominent Ministries, particularly in the Communications and Health Ministries. Powerful pro government unions in the Ministry of Health aligned with corrupt Deputies in Congress were able to gather the requisite votes to interpellate the Minister of Health as part of an attempt to force her resignation. The process was recently dropped due to the support garnered from civil society organizations and private sector institutions like FUNDESA that are supporting the Minister of Health in her fight against corruption.⁵

A civil society leader and human rights activist interviewed for this report suggested that corruption is now deeply embedded in the institutional and political fibers of the country. He argued that the measures taken by President Morales are insufficient, and that major reforms of laws governing political parties, the electoral process, and the Civil Service are all necessary to genuinely address corruption.

3 Business and Investment Environment

The Constitutional Court is about to issue a final and unappealable ruling potentially calling for the definitive suspension of the government's water-rights license and thus the hydroelectric projects of OXEC I and OXEC II. The OXEC clean energy projects represent an investment of nearly US \$300 million in approximately 100 MW of generation capacity. The Ministry of Energy and Mines performed a prior consultation of the potentially affected communities as per the guidelines of the ILO Convention 169. However, the lack of

³ <http://www.insightcrime.org/news-briefs/us-indicts-fmr-guatemala-vp-fmr-interior-minister-on-drug-charges>

⁴ <http://www.insightcrime.org/news-analysis/defining-mafia-state-case-guatemala>

⁵ <http://lahora.gt/ven-intereses-politicos-interpelacion-ministra-salud/>

implementation of a regulatory framework is being misconstrued as the basis for the license suspension.

The risk is the judicial precedent that would give rise to major economic implications in a country with over US\$7 billion in recent energy investments. This in turn would spark massive social unrest derived from the rapid increase in electricity prices and the dramatic economic slowdown.

The potential court decision not only violates the spirit of the ILO Convention 169 but also undermines one of the main pillars of the Alliance for Prosperity Plan for the Northern Triangle of Central America and will become a serious impediment for future infrastructure development.

The Guatemalan government is working to find a balance between ensuring future infrastructure development and remaining compliant with ILO Convention 169. The Guatemalan government signed and ratified Convention 169 of the International Labour Organization (ILO) on the Rights of Indigenous and Tribal Peoples in 1996, but lacks clear regulation on its implementation. Despite repeated attempts to implement a framework for the consultation procedures to indigenous communities, the matter remains vague and undefined. The absence of regulation is being abused by certain unscrupulous actors to destabilize the energy sector, while threatening the welfare of citizens, financial institutions and the overall economy of the country.



Oxec II Hydroelectric Plant, under construction
Picture by: Solel Boneh

In January 2016, the Supreme Court suspended the license given to Energy Resources Capital Holding (ERC) and Oxec I and II to operate the hydroelectric plant, citing the inadequacy of the consultation process. The company has filed an appeal to the Constitutional Court, arguing that their consultation process met the guiding principles set by the Ministry of Energy.⁶

The regulatory uncertainty produced by the Oxec case places future investments of a similar scale at risk, in exactly those regions where they will be most needed. Investments in the Western Highlands are crucial to generate opportunities, create jobs and reduce outward migration to the US. To address this need, the Foundation for the Development of Guatemala (FUNDESA) and the Private Competitiveness Council (CPC) are working together with the Ministry of Finance of Guatemala and institutions like the National Competitiveness Program (PRONACOM) to support a strategy to increase foreign investment in infrastructure.

In March 2017, members of the Congressional Labour Commission travelled to Geneva, Switzerland to present recent changes to Guatemala’s Labour Code to the International Labour Organization. Congress spent five years debating the changes, which have now

received approval. This will give the Ministry of Labour and General Labour Inspectorate greater powers to force companies to comply with labour regulations and international agreements.⁷

It is expected that the new provisions will help increase formal employment as 69% of the workforce is currently employed in the informal sector, according to the National Statistics Institute. The ILO had previously suggested that it would establish a Commission of Inquiry in Guatemala, had the country failed to take decisive action to address the situation.

Congress has approved a controversial new bill intended to formalise taxation in the agriculture and livestock sectors, despite being faced with significant criticism. ‘The Bill to Simplify, Update and Incorporate Taxation on the Agricultural and Livestock Sectors’ stands to reduce tax income to 5%, and eliminate Value Added Tax for individuals earning less than US\$407,608 per year. It also proposes simplifying the tax structure and combining taxes into a single payment. This will have a major impact distorting prices, since products sold by corporations will have to pay Value Added Taxes, but those sold by individuals will only pay 5% total tax (VAT will be excluded only for individuals).

The initiative was launched as a means to address rampant non-payment of taxes, instead incentivising individuals to pay taxes by lowering the tax burden. This is especially the case in the cattle industry, in which some ranchers have never paid taxes, despite laws requiring them to do so.

The plans have been criticized by both the Chamber of Commerce and the Chamber of Industry of Guatemala. A number of think tanks specializing in taxes, including the Central American Institute on Fiscal Studies (ICEFI), have also warned that the bill risks distorting the market by giving out special privileges to this sector. At the time of writing, the initiative has been approved by Congress after a third debate, and is now pending approval in a final debate that would convert the controversial legislation into law.

Indigenous Jurisdiction and Judicial Sector Reform. Congress is evaluating a Constitutional Reform aimed at strengthening the Judicial System. The package includes amendments aimed at improving the civil service career within the judicial sector, improving the selection mechanism for attorney general and supreme court magistrates, among others. For the most part, the proposed reforms are viewed favourably although they have faced stiff resistance from Congress. Unfortunately, the original reform proposal included a poorly drafted article on Indigenous Jurisdiction which lacked broader social consensus. The article on Indigenous Jurisdiction proved controversial as it placed all of these unwritten and community based practices at the same level as the Supreme Court. The proposal seemed to ignore that the country has over 22 linguistic communities and thousands of independent indigenous authorities. Placing unconstrained indigenous jurisdiction at the same level as the Supreme Court, would lead to conflicting multiple parallel legal and judicial systems. This is something unlike any other country in the region has ever attempted and would likely lead to the “Balkanization” of Guatemala. It will also put at risk the ability to enforce labor laws, international trade agreements, fiscal policy, and drug trafficking conventions. This would represent a constitutional breakdown

⁷ <https://www.publinews.gt/gt/guatemala/2017/03/19/regresan-capacidad-sancionar-inspeccion-general.html>

in our judicial system risking democracy, liberty, and rule-of-law, sending the country back nearly 50 years.

4 Business Intelligence and Investment Opportunities

The Government of Guatemala has prioritised tourism as a sector for investment. The strategy ties in with a number of new international openings in the hospitality sector. After nine years, the Marriott brand is returning to Guatemala City, with the opening of its new Courtyard by Marriott hotel in Zone 10, due to take place before the end of 2017. Marriott have invested US\$25m in the new property.⁸

Another hotel opened this month in the municipality of Quetzaltenango. It will be run by the LatAm group, and is the result of a US\$6.4m investment.⁹ A third hotel is expected to open in Guatemala City later this year under the Hyatt Regency brand. These hotel openings, combined with the construction of new airports in key tourism destinations, will strengthen the Guatemalan tourism sector, with the hope that it will ultimately be able to compete with other regional destinations.

Arturo Calle, a Colombian men's fashion brand, will open its first store this month, becoming the latest in a line of Colombian companies to expand operations to Guatemala. With an investment of US\$1.5m the Arturo Calle brand will open a new store in Zone 10, in Guatemala City's Oakland Mall.¹⁰ This investment is one of several recent Colombian investments in the country. Colombia is the second largest investor in Guatemala after the US, with investments of US\$75.8m between January and September 2016, according to the Central Bank of Guatemala.¹¹

The government has launched a US\$387million investment programme intended to carry out repairs on 20,000 km of roads and highways and 249km of new roads. The programme is part of President Morales' Urban Agenda which he presented at the National Business Forum (ENADE) at the end of last year.¹² As well as creating opportunities for companies investing directly in the construction of road infrastructure, there will also be opportunities for the construction sector to provide ancillary services. Bidding on the Urban Agenda will begin in May 2017.

5 International Relations and Foreign Investment

A joint private and public sector commission travelled to Washington D.C. at the end of March 2017 to present a series of investment opportunities at the Council of the Americas. Guatemala was the focus of a group of investors affiliated to the Council of the Americas in Washington D.C.¹³ The trip became an important opportunity for Guatemalan business and

⁸ <https://www.publineas.gt/guatemala/2017/03/15/llegan-nuevos-hoteles-pais.html>

⁹ <http://elperiodico.com.gt/economia/2017/03/16/inversion-hotelera-de-us6-4-millones-llega-a-xela/>

¹⁰ <http://www.masfranquicias.com/arturo-calle-ingresara-guatemala/>

¹¹ http://www.banguat.gob.gt/inc/ver.asp?id=/Publica/v_man_bpagos/flujo_IED_2016.htm&e=128619

¹² <http://www.eleconomista.net/2017/03/01/gobierno-de-guatemala-recuperara-unos-20000-kilometros-de-carretera-en-2017>

¹³ <http://www.as-coa.org/events/guatemala-creating-path-growth>

public sector leaders to meet with representatives of the Trump Administration to discuss ways of reducing migration through investment. Indeed, according to a high-level director of CACIF (the private sector co-ordinating committee), the Guatemalan delegation also met with Acting Deputy Secretary of State, Mr Thomas Shannon, as part of the agenda.

Mr Shannon is currently playing a central role in coordinating many of the projects of the Plan for the Alliance for Prosperity in the Northern Triangle, whose mandate includes enabling environment for sustained growth, stability and prosperity. To this effect, Mr Shannon commented that the event constituted an important opportunity to present the different investment projects that have been identified in the infrastructure agenda, which could have an important impact on reducing migration and alleviating poverty, especially in the Western Highlands.

US Assistant Secretary for International Narcotics and Law Enforcement Affairs, William Brownfield, visited Guatemala for three days in March. The visit suggests that the US will continue to engage with anti-corruption and counter drug-trafficking measures under President Trump. During the visit, Assistant Secretary Brownfield met with President Jimmy Morales to discuss crime reduction and border security.¹⁴ He also attended the inauguration of a new jail for women, modelled on the prison system in the Dominican Republic.

The new prison will provide inmates with education and training to increase their employability after release, and reduce the chance of recidivism. Assistant Secretary Brownfield congratulated President Morales for working together with the International Narcotics and Law Enforcement Affairs Office to implement this new prison model. The government plans to open five new jails and begin transferring all prisoners to this new system, as part of continued efforts to improve security and justice in the country.

End.

¹⁴ <http://www.minex.gob.gt/noticias/Noticia.aspx?id=26924>