

Briefing – National Entrepreneurs Council

Re: Understanding the fundamental roots of migration and agenda for economic modernization:
Guatemala's economic structure and its ties to economic stagnation

Guatemala's economic and political system is extremely dysfunctional and pushes its citizens to leave the country for the United States. It does, **however, allow a selected group of insiders to reap benefits from the lack of governance and economic underdevelopment.** Remittances sent from immigrants established in the US concentrate the **economic activity dominated by historical elites, entrenching their political reach,** and granting them veto power over economic and institutional reforms, including the modernization of the tax authority and the implementation of an effective antitrust framework, and reform of the judicial system, among others. **The lack of acknowledgement of this intricate dynamic between the economic structure and the flawed institutional environment could seriously jeopardize US-led efforts to reduce migration.**

- Throughout the entire history of Guatemala, the country has been **heavily reliant on exports of commodities and other agricultural goods such as coffee, bananas, and sugar.**
- Although the Peace Accords of 1996 paved the road for Guatemala to reengineer and strengthen its institutional and economic framework, the efforts fell short as the fundamental roots of migration, i.e., violence, corruption, and **economic stagnation, continued to push increasingly growing numbers of people out of the country.** Per capita GDP in Guatemala has only grown 1% per annum in real purchasing-power parity terms over the last twenty years.
- The economic structure of Guatemala has since been slowly shifting away from a pure reliance on commodity exports towards an inward-oriented economy based on **non-tradable sectors, such as retail, construction, and consumption goods.** In 2020, non-tradables represented 73.0% of gross value added (GVA), as opposed to 63.8% twenty years earlier. **Remittances currently represent the equivalent of 15% of GDP.**
- The exponential growth in remittances has **indirectly subsidized the non-tradable sector** through the economic phenomenon known as “Dutch disease” whereby concentration in one low-productivity sector deters the development of other more promising activities. Productivity gains are restricted under such circumstances, **since non-tradables have a lower spectrum of economic complexity.**
- **But more subtly, however, concentration in non-tradable sectors entrenches economic elite's sphere of political influence through increased economic power, as they dominate these sectors unencumbered.** This self-perpetuating cycle grants them an indirect veto power over any political and economic reform project in the scale needed in Guatemala to materially ameliorate its outlook.
- Hence, acknowledgement of the pernicious ties between the economic and political elites, amplified by economic inwardness, will determine the success of a US-led effort to **break the vicious cycle of economic stagnation and institutional fragility that drive Guatemalans to leave the country,** often at the risk of their own lives.
- Economic elites have thus far **avoided external and internal competitive pressures by protecting certain features of Guatemala's economic architecture,** through lobbying against institutional reforms and by partaking in corruption and other misconduct.
- **The tax collection agency, SAT, has extremely weak audit and enforcement capacity, thereby favoring incumbents.** Corporate income tax fraud and non-compliance is rampant, amplified by complex corporate structures which are typically employed by the elites' family conglomerates. **Guatemala has one of the lowest figures of tax revenues as share of GDP in Latin America, currently standing at 10%.**
- Traditional business interests hold significant sway over **public institutions through representation at their managing boards.** This includes investment promotion agencies, which are the official channel to international markets and communication with overseas investors.
- One crucial aspect of the clustering of Guatemala's business elite has to do with ill-obtained market dominance. **Guatemala is among the few countries in the world without a comprehensive and enforceable antitrust legal framework.** Evidently, such legal vacuum gives free rein to all sorts of market abuses, collusive practices and more generally restriction of trade.

- **Guatemala’s capital markets are underdeveloped and remain extremely concentrated.** The banking sector represents 87% of the entire financial system and the three top banks hold 55% of total banking assets. Such concentration explains partly why credit penetration, crucial in the development of new businesses, remains among the lowest in Latin America, at 35% of GDP. The stock market in Guatemala is virtually non-existent.
- **Several leading figures of the traditional business community play a central role in Guatemala’s ubiquitous corruption.** The typical corruption schemes involve illegal campaign contributions, collusion to secure public procurement contracts (mainly in construction and healthcare), bribes to deputies at the National Congress to obtain tailor-made laws favorable to business interests, and bribes to tax authorities to skip compliance or to actively defraud the Guatemalan government.

An Agenda for Economic Modernization: A New Economic Governance Framework for Guatemala

Based on the facts presented here, **we firmly believe, as businesswomen and businessmen that close cooperation with the US and its administration can act as a catalyst to pursue a political and economic transformation** which addresses the fundamental causes of migration. **We need a new economic governance framework**, as the current institutional environment privileges incumbents who have acquired economic privileges on the back of Guatemala’s historical institutional flaws. **No initiative will prove transformational unless these circumstances are acknowledged and adequately addressed.** As part of a first set of proposals, we envisage the several initiatives that could kick start a process of economic modernization:

- **Creation of a local development bank with a hybrid governance structure**, with US authorities and other international stakeholders retaining the administration and deployment of funds. As it occurred during the resounding success of the US-led European Recovery Program (the “Marshall Plan”) after World War II, access to credit and funding proved crucial in the reindustrialization and modernization of the European economy. **The bank could fund strategic projects with the aim of boosting local productivity.** This initiative would also tackle the extreme concentration of the financial sector.
- **Technical assistance for the process of deepening local financial markets**, the development of financial markets will prove instrumental to connect idle prospective business and capital while also opening the Guatemalan marketplace to foreign investment.
- **Technical assistance for the establishment of competent antitrust authorities.** As it was previously highlighted, the lack of an antitrust framework severely deters the entrance of new players while also fostering corruption and other business misconduct. The US could also play an active role in garnering support for the enactment of comprehensive antitrust legislation, especially by conditioning material development funding to its approval.
- **Boost financial inclusion through Financial Technology (“FinTech”) platforms.** Considering that remittances play a central role in the lives of millions of Guatemalans, FinTech could play a central role in increasing financial inclusion for minorities who have historically lacked access to the most basic banking services while also addressing the issue of concentration in the financial sector.
- **Reignite a proactive and substantial effort against corruption.** We welcome recent announcements by the Biden-Harris administration to launch a regional commission in the Northern Triangle to actively fight corruption. Successes posted by the CICIG commission demonstrated how international cooperation can play a leading role in breaking the cycle of misconduct and collusion. Moreover, we would also welcome a more active involvement of US authorities by an increased use of the foreign and economic policy tools currently at their disposal, including comprehensive sanctions against individuals involved in flagrant corruption.
- **We are in urgent need of stronger public institutions.** The current institutional framework cannot continue as it stands, and comprehensive reform is required. The US can play a leading role by conditioning aid and investment to fulfillment of significant institutional reforms, especially in areas pertaining Civil Service, Electoral Matters, and Judicial Independence.

As it has done historically and in many different geographies and during different historical periods, the US can lead a comprehensive effort to alter the worrying trend of migration and the humanitarian crisis it has unleashed at its southern border. **We firmly believe that the new administration and its proven willingness to comprehend the fundamental causes of migration will present a unique window of opportunity to finally stop an avoidable human drama.**