The Systemic Weakness of Guatemala's Competitiveness

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Introduction

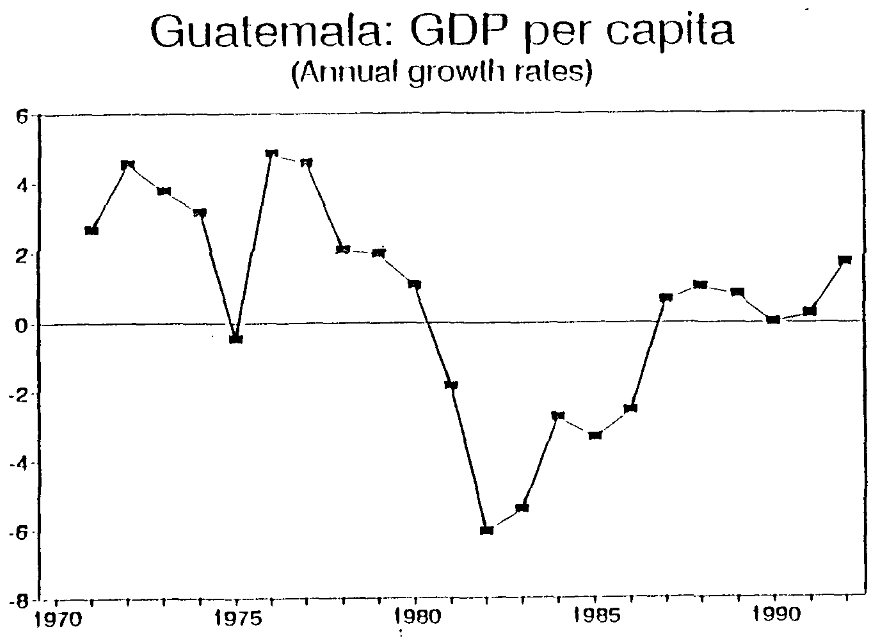
In response to disequilibria, traditional economic theory tends to concentrate on the need for stabilization and on "getting prices right" through appropriate exchange rates that favour the production of tradeables, and through tariff reductions and incentives that eliminate export biases or favour exports outright. However, it has become increasingly clear that the development of international competitiveness goes beyond this simple recipe, and that it has additional "systemic" requirements (CEPAL 1990). Guatemala's experience, specially from 1987 to 1992, illustrates how the initial contribution of stabilization and the exchange rate to growing exports may be threatened by the weakness of these other requirements. These include physical infraestructure, education, and institutional arrangements.

This paper deals with some of these subjects, starting with a description of basic exchange rate and trade policies adopted from 1980 to 1992, while attempting to determine their effects on export and investment performance. The paper ends with a section on the systemic obstacles that exports in Guatemala must overcome to expand further.

1. Exchange rate policy and stabilization

The economic crisis and the negative growth rates of GDP between 1981 and 1986 in Guatemala (chart 1) were triggered by four types of shocks: deteriorating terms of trade, including rising oil prices and falling prices of traditional export commodities (coffee, cotton, sugra, bananas and meat); capital flight associated with political uncertainy; falling exports (mostly industrial products) to other Central American countries; and plumetting tourist receipts (from US$ 82 million in 1979 to US$ 7 million in 1983) associated with a situation of increasing political violence and internal war. However, since Guatemala's foreign external debt in the early 1980s (61 percent of GDP in 1980) had not reached the same high level of other Latin American countries (e.g. Mexico with 335 percent in 1980), there was not a negative transfer of resources abroad, and Guatemala covered its current account deficit by increasing its level of public debt significantly during the first half of the 1980s.

Chart 1



Source: Banco de Guatemala

Thus, wheras the already highly indebted Latin American countries were forced to devalue during the first half of the 1980s, Guatemala did so only during the second half (CEPAL 1992b). Furthermore, psychological and political obstacles to devaluation were strengthened by the remarkable stability of Guatemala's currency in the past, which had been pegged to the US dollar on a one-to-one basis since 1926 (Bulmer Thomas 1989, p.40). Historically adjustment to external shocks had taken place basically through changes in the level of domestic activity and in reserves, rather than through changes in relative prices.

This orthodox adjustment mechanism no longer operated during the 1970s and especially the 1980s. The collapse of traditional agricultural exports meant that the basic pillar which underpinned Guatemala's exchange rate ceased to exist. An initial indicator of this process was the double digit inflation experienced in most years from 1973 to 1981. This phenomenon, not observed in Guatemala since the 1920s, gradually appreciated the exchange rate in real terms and contributed to increase external imbalances, which were further worsened by increased public expenditure undertaken to compensate for falling domestic activity.

Initial stabilization programmes, from 1982 to 1984, tried to balance the economy without modifying the exchange rate. Attempts were made to reduce domestic absorption through lower government expenditure (mostly investment) and the introduction of a value added tax, while establishing strict import quotas. Although the trade and current account balance improved in 1983, GDP, exports and investment fell without prospects for improvement, and the real (effective) exchange rate continued to appreciate during the first half of the 1980s (table 1).

Adjustment of the exchange rate proved to be a drawn-out, complex and uncertain process. In 1984 a multiple exchange rate system was introduced, maintaining one rate at the official parity with the US dollar, while allowing for the existence of a depreciating parallel rate. Different fractions of export proceeds were compensated at different rates, and although the parallel exchange rate was allowed to devalue sharply in 1985, various regulations limited the inducement to export. Furthermore, the commitment to maintain an official rate applicable to certain imports (including petroleum) and to debt service payments gave rise to Central Bank losses, due to foreign exchange receipts obtained at the official rate which were lower than obligations at that same rate. This gap, which increased with the growing differential between the official and the parallel rate, contributed to a higher global public sector deficit. The latter, combined with the devaluation of the exchange rate, led to higher inflation rates in 1985 and 1986 (table 1).

Thus, the newly elected Christian Democrat government which took office in 1986 faced, in practice, 33 different exchange rates (SEGEPLAN 1991, p. 38) and mounting inflation. In June of 1986 the new government proceeded to simplify the exchange rate system and established three rates (for official transactions at 1 quetzal per US$, the regulated market at 2.50, and the free banking market).

However, the elimination of exchange rate regulations, pent-up demand and renewed growth in 1987 and 1988 resulted in a surge of imports, which a 1987 failed tax reform was unable to

Table 1

Basic Macroeconomic indicators (percentages)

	CA/GDP	% P	PD/GDP	REER	GDP p.c
1980	- 2.1	9.1	n.a.	124.9	1.1
1981	- 6.7	8.7	7.2	110.9	- 1.8
1982	- 4.9	- 2.0	4.5	113.5	- 6.1
1983	- 3.0	15.4	3.3	113.6	- 5.4
1984	- 5.0	7.2	4.3	113.1	- 2.7
1985	- 3.3	27.9	5.5	100.0	- 3.4
1986	- 0.6	21.4	5.7	141.8	- 2.6
1987	- 7.0	9.3	3.1	185.2	0.7
1988	- 6.0	12.3	5.4	186.1	1.0
1989	- 5.1	20.2	5.6	187.9	0.8
1990	- 2.5	59.8	3.2	220.4	0.0
1991	- 1.9	10.0	0.8	192.6	0.3
1992	- 8.8	14.3	n.a.	190.6	1.7

Source: CEPAL, with the exception of data on the global deficit of the public sector, which originates in World Bank (1987) and SEGEPLAN (1991 and 1992).

Note: CA/GDP refers to: the current account balance as a proportion of GDP; % P: the rate of inflation (from December to December); PD/GDP: the global public deficit (including fiscal deficit and Central Bank losses) as a proportion of GDP; REER: Real Effective Exchange Rate; and GDP p.c.: annual growth rate of GDP per capita.

dampen,[1] and which coffee exports with declining prices could not compensate. This led the Central Bank authorities to devalue by 8% in June of 1988, while they merged the regulated and banking markets, setting an exchange rate of 2.7 for both. Although in theory it was conceived as a crawling-peg, internal political opposition to devaluations resulted in the rate being pegged at 2.7 until July of 1989. At this point, and faced with a continuing and unsustainable current account deficit, fed by a growing public sector deficit (including significant Central Bank losses), the exchange rate was devalued by an insignificant 3 per cent. This only exacerbated devaluation expectations and reduced international reserves until the monetary authorities decided to free the exchange rate. The value of the quetzal in terms of dollars then plunged by 26 per cent, to Q 3.5 per dollar.

Exchange rate instability only worsened in 1990. An attempt to establish a "band" was abandoned due to insufficient liquidity on the part of the Central Bank, and an informal agreement with the commercial banks in April led to the establishment of a new rate, of Q 4.25, supposedly fixed. At the same time interest rates were freed, in the hope of reducing excess demand, facilitating capital inflows and improving the efficiency of financial intermediation. In practice the cartelized commercial banks agreed among themselves to keep interest rates fixed and allowed the exchange rate to sink even further, involving a clearly inequitable adjustment process: bank profits increased and real wages fell. The Central Bank then established a system of auctions, which finally led to a new rate of Q 5.8 per dollar, representing a nominal devaluation of more than 100% in less than a year.

The new government that took over in 1991 faced both internal and external imbalances: the highest inflation (60 per cent, comparing end-periods) in modern Guatemalan history and arrears with the World Bank and other financial institutions. A new stabilization package was applied, involving a restrictive credit policy, a reduction of government expenditure in real terms, and increased receipts due to improvements in tax administration and to the sale of emergency bonds, equivalent to a once-and-for-all tax increase. A massive capital inflow from abroad, shared by other countries in Latin

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[1] The extreme opposition of Guatemala's private sector is particularly remarkable, given the country's low level of taxation, there being a long history of failed tax reforms. Best (1976) finds that in most cases in Central America the actual composition of taxes have corresponded to the hypothetical composition of taxes based on the preferences of landowners, and have been the reverse of the preferences of the majority of the population.

America, was sterilized through open market operations, but at the cost of significant Central Bank losses (1.5 per cent of GDP).

Nevertheless, reserves were accumulated, and together with the other fiscal and monetary measures this helped to stabilize the exchange rate. Conceived as an anchor to reduce the inflation rate, its continued devaluation was halted and it appreciated somewhat in real terms. This policy was maintained in 1992. Relatively expansionary fiscal and monetary policies together with the economy's higher growth rate contributed to a deteriorating trade balance. Both private and public capital inflows (aided by the elimination of arrears) were sufficient to compensate the much wider current account deficit (8.8 percent of GDP) without significant changes in Guatemala's international reserves, though making it clear that Guatemala's external adjustment still had a long way to go. Nevertheless, a tax reform approved in 1992 provided greater possibilities for keeping the fiscal deficit under control subsequently.

2. Tariff and non tariff barriers

Although the evolution of the exchange rate from 1986 to 1992 clearly favoured the relative prices of tradeables *vis a vis* non-tradeables in Guatemala, the relation between import substitutes and exports established by means of the Central American Common External Tariff in 1959 was not significantly altered during this period. And even though the main explicit objective of the CET was to have common fiscal treatment of imports from third countries so as to facilitate trade among CACM members, thereby avoiding trade deflection, it also promoted import substitution, favoured greater fiscal revenues, took into account balance of payments concerns, and was conceived as a common bargaining instrument. Non-durable consumer goods, the most important part of industry in the region, were granted higher protection, capital goods were granted low protection assuming they would have to be imported, and raw materials and intermediate products were granted only slightly higher protection. Furthermore, the need to ensure sufficient revenues and to assist in maintaining balance of payment equilibrium meant higher tariffs for non-essential and luxury products.[2]

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[2] Most of these factors were already implicitly incorporated in the national tariff structure of each Central American country, so it is not surprising that the average tariff structure which the five individual countries had in 1959, before agreeing on the CET, was not very different from the

Fiscal incentives, applied through the exemption of tariff payments for imports of capital goods and other inputs, and stimulated by competing efforts to attract foreign investment (what was called "incentive wars"), further increased effective protection of final goods, particularly of non-durable consumer goods. Therefore, the structure of incentives favoured investment in the production of final goods, often import-intensive or of a "final-touch" nature, at the cost of regional production of raw materials and intermediate inputs. It can also be argued that an anti-export bias was introduced, although the fact that free trade was agreed upon within Central America meant that this did not apply to intra-regional exports, which expanded at a rapid though declining rate from the late 1950s until 1980. Furthermore, effective protection rates tended to be significantly lower in Central American countries than in other developing countries during the 1960s and 1970s (Rapoport 1978).

Recognition of the problems involving the structure of protection, arising especially from fiscal incentives, led to a revision of the CET in 1986. Although overall effective protection was not reduced very significantly (from 46.2 to 38.2 per cent), dispersion fell to a greater extent (from 62 to 29 per cent), while anti-export bias remained largely unchanged (World Bank 1987, pp. 37-8). It was only after Guatemala's entry into GATT in 1991 that tariff rates began to be reduced gradually, until a new CET with a maximum rate of 20 per cent was adopted in early 1993. Consequently, the impact of tariff changes on the development of extra-regional exports does not appear to have been significant from 1986 to 1992.

As opposed to larger Latin American countries, Guatemala did not rely to a significant extent on quantatitive restrictions during most of the import substitution industrialization period, although they were applied in the agricultural sector. However, deteriorating exports and capital flight associated with the economic and political crisis in Guatemala and Central America in general led to the imposition of quota allocations used to repress import demand from 1982 to 1984. External credit arrears and multiple exchange rate regulations restricted imports further, until 1986.

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structure of the CET finally agreed upon.

3. Export incentives

The absence of a clear trade strategy in Guatemala is clear from a brief review of legislation applied to trade as of 1980, particularly regarding non-traditional exports. In addition to a rather ineffective free export processing zone (CCI 1989, p. 52-3) established in the port of Santo Tomás de Castilla during the early 1970s, a special regime involving tariff exemptions for inputs utilized by firms exporting non-traditional products outside of Central America was established in 1983 (DL 80-82). However, at the same time the Guatemalan export promotion agency (GUATEXPRO), in charge of evaluating applications to benefit from this regime, was dismantled.

A year later this scheme was replaced by an allegedly more precise new regime for industrial exports (DL 21-84) destined to non-Central American countries. This regime included tariff and income tax exemptions (for ten years) of firms which exported all of their production, but excluded income tax and tariff exemptions applied to fixed capital and fuels in the case of enterprises which only exported part of their production.

A subsidies scheme involving tax credits (*certificados de abono tributario*, CATs) for non-traditional exports in general was also established (DL 73-83 and 22-84). However, limited use was made of these subsidies since they were suspended in 1986, on the basis of the argument that the newly established exchange rate system provided sufficient incentives.

Furthermore, a fund to guarrantee bank credit for agricultural exports was established in 1982 (DL 35-82), but a year later it was converted into a fund directed at guarranteeing credit for agricultural activities in general, but excluding commercialization activities (DL 22-83).[3] Another example of contradictions of the trade policy of the government newly established in 1986, allegedly in favour of integrating the national economy into the world economy, was to establish taxes on

[3] Two additional decrees applied to the industrial sector, although without favouring exports specifically. A law to promote industrial decentralization through partial income tax exemptions and preferentila financial assistance to be channelled through CORFINA, a public financial institution, had been established in the late 1970s. However, the financial crisis of CORFINA and the restricted nature of other income tax incentives limited the effects of this legislation. At the same time a decree to promote small enterprises included partial exemptions of income taxes and tariffs for raw materials and equipment, as well as pre-investment credit and credit guarantees.

exports (including a 4 percent tax on non-traditional exports), on customs services and on the use of international telecomunication services.

Greater progress was made in 1989, when the regime covering industrial exports (DL 21-84), was replaced by a more general and comprehensive law of promotion and development of exporting and *maquila* activities (DL 29-89). Distinguishing more precisely between different types of exporters and regimes (temporary admission, duty drawback, indirect exporters, and exporters using wholly national inputs) it established in each case the corresponding coverage of exemptions applying to imported inputs, capital goods, value added taxes, and/or income taxes. A very open foreign investment regime was also consolidated two years earlier, by simplifying the procedures associated with the application of a bilateral investment agreement signed with the United States in 1969.

4. The performance of exports

The average annual growth rate of all major categories of exports (traditional agroexports, industrial products sold in Central America and non-traditional exports to the rest of the world) was negative from 1981 to 1986 (table 2). However, the real devaluation (begun in 1985) and simplification of the exchange rate system (1986) appear to have been the major determinants of growing exports since then (graph 2). After gradually appreciating in real terms until 1985, the real effective exchange rate was kept at a level equivalent to a devaluation of almost 100 per cent in the years following 1986/7. For the first time in the 1980s all categories of exports grew in 1987, and only traditional exports experienced negative growth rates thereafter, due to exogeneous terms of trade variations (table 2). Therefore, the "late" increase in Guatemalan exports, when compared to most other Latin American countries during the 1980s, can be attributed mostly to the late devaluation of its currency.

The effects of devaluation were partly reinforced or neutralized by other factors. For instance, deteriorating terms of trade are crucial in understanding the falling share of traditional export products (cotton, sugar, banananas, coffe, cardamom and meat) in Guatemala's total exports, which decreased from 74 per cent of total exports in 1986 to 43 percent in 1992. However, this did

Table 2

Traditional and non-traditional exports
(% annual growth rates)

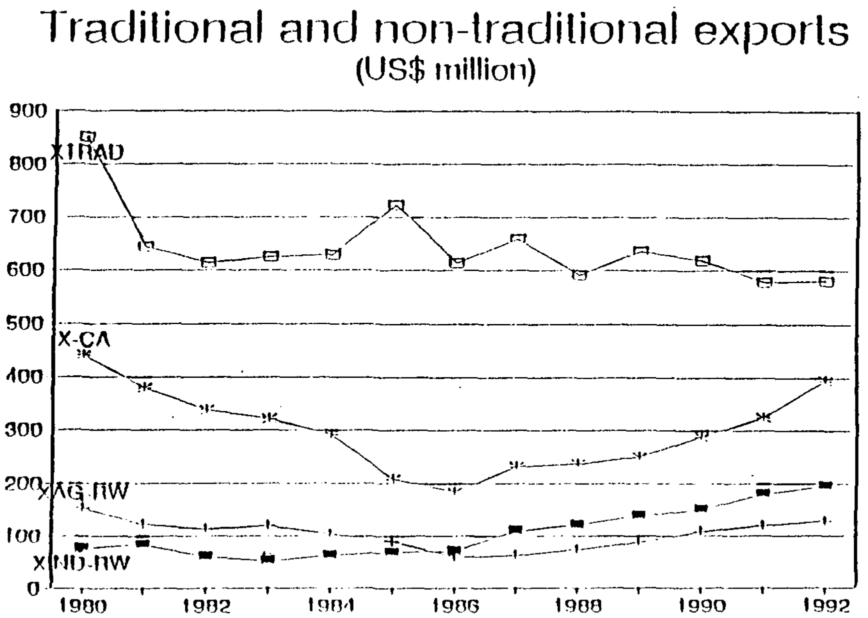
	XIND-RW	XAG-RW	X-CA	XTRAD
1981	7.9	-19.7	-14.1	-24.4
1982	-28.0	- 8.2	-11.1	- 4.8
1983	-13.6	6.3	- 4.7	2.0
1984	19.6	-13.4	- 9.3	0.5
1985	9.8	-13.6	-28.5	15.2
1986	4.5	-34.8	-11.1	-15.1
1987	57.1	5.2	24.9	7.2
1988	10.0	19.7	2.2	-10.0
1989	13.2	17.8	5.5	7.4
1990	9.5	24.4	15.7	- 2.7
1991	20.0	12.1	12.5	- 6.5
1992	7.8	5.8	21.9	0.2

Source : Own estimates on the basis of data from the Banco de Guatemala.

Note : XIND-RW refers to: Industrial exports to the Rest of the World; XAG-RW: non traditional agroexports to the Rest of the World; X-CA: Exports to Central Central America (largely industrial products); XTRAD: Traditional exports.

not occur in the case of sugar, which benefitted from a rather perverse and selective policy which sets it apart from other traditional exports. Specifically, and in addition to the exchange rate's devaluation, sugar producers (a powerful oligopoly consisting of a limited number of sugar refineries) benefitted from an internal guarrantee price which can be considered equivalent to a subsidy. Thus, in spite of uncertain prospects in world markets, sugar exports increased continuously from 1987 to 1992, almost doubling their share of Guatemalan total exports from 6.5 percent in 1987 to 12.2 in 1992.

Chart 2



Source: estimated on the basis of data from the Banco de Guatemala.

Note: XTRAD refer to traditional exports; XCA to exports to Central America; XAG-RW to non-traditional agroexports to the Rest of the World and XIND-RW to industrial exports to the Rest of the World.

4.1 Non-traditional exports

Initial reaction to devaluation appears to have been greatest in the case of non-traditional industrial and agricultural exports directed to non-Central American markets, which had their share in total exports increase from 17.4 percent in 1987 to 24.8 percent in 1992. Industrial exports had been growing since 1984. Devaluation reduced already low real wages further, one of the primary --and in some cases, sole-- sources of competitiveness in this sector. This coincided with a significant increase in apparel assembly activities taking advantage of United States policy pertaining to its tariff heading 9802.00.80 that provides tariff relief for goods imported by the US that were assembled in foreign location and that contain US-made products. In 1989 Guatemala entered the list of principal sources of US imports under heading 9802.00.80, exporting US$ 80 million that year and US$ 118 million a year later, approximately half of it duy-free, corresponding to US components (USITC 1990). This is partly the result of Guatemala having become the main destination of Korean foreign direct investment in Latin America during the second half of the 1980s, with firms specializing in exports of textiles and apparel for the US market while taking advantage of close links with Korean families who had emigrated earlier to the US (CEPAL 1992c).

However, exports undertaken under US tariff heading 9802.00.80do not --unlike the cases of Mexico, the Dominican Republic and Haiti-- comprise most Guatemalan exports of industrial products to non-Central American countries. Up until 1989 approximately 200 firms benefitted from the special regime for non-traditional industrial exports (DL 21-84), but less than half of these (80) were firms involved in assembly (*maquila*) activities (CCI 1989, p.52). In addition to textile and apparel products not exported under the special US tariff heading, other exports have included mostly agro-industrial goods, usually highly intensive both in the use of labour and of natural resources (mostly processed food products, wood products and tobaco products).

The border-line between agroindustrial products and other agricultural non-traditional exports is not very clear, and Guatemala's not always explicit trade strategy has usually lumped them together, as non-traditional products. This is consistent with the view that attaches greater priority to the search for international competitiveness as a whole, rather than to the promotion of industrialization *per se*. More specifically, it takes into account the fact that technical progress must not be restricted to industry, and that it must extend to all facets of economic activity (CEPAL 1990, chapter IV).

Furthermore, non-traditional agroexports (including vegetables that benefit from Guatemala's numerous microclimates and a year-round growing season), which also grew significantly from 1987 to 1992, appear to provide possibilities for greater equity than traditional exports. Specifically, the small scale production for export and the role of vegetable exporting cooperatives which include numerous small producers in Guatemala has been heralded as a success story (CEPAL 1990 p.137). Moreover, the associative nature of these organizations may facilitate their articulation with agrobusiness and the difusion of technology required to meet the ever more demanding standards required in world markets.

Consistency concerning the wider meaning of international competitiveness also requires taking into account Guatemala's most important service exported, tourism, although it is increasingly viewed as a traditional rather than as a non-traditional foreign exchange earner. Tourism receipts grew gradually after 1983, overcoming the level attained earlier (1979) only ten years later (1989), suggesting a lower response to exchange variations (lower price elasticity) and greater dependence on political conditions. Perception of greater stability appears to have contributed to a significant growth of tourism in 1991 (60 percent) and 1992 (25 percent), which in the latter year represented approximately 25 percent of the value of exports of goods. Guatemala's combination of natural and historical attractions clearly allows for a gradual upgrading of facilities to increase tourism belonging to high income brackets, rather than relying on greater mass-tourism.

4.2 Traditional industrial exports

As in most other Latin American countries the manufacturing sector's output declined even faster than GDP, specifically from 1980 to 1985 (table 3). Domestic recession, lack of foreign exchange for an extremely import-intensive sector, and reduced exports to the rest of Central America as a result of recession and changing exchange rates in these countries accounts for Guatemala's industry's negative average annual growth rate from 1981 to 1986. In the midst of recession, and partly as a result of import restrictions, an inefficient process of national import substitution took place during the mid 1980s, since the proportion of apparent consumption accounted for by national production increased at the cost both of intra and extra regional imports (Fuentes 1989). However, this process did not compensate the reduction of exports to Central America, which fell from approximately 20 percent of total industrial production in 1980 to about 8 percent five years later, nor did it compensate the effects of domestic recession.

The largely import-intensive industrial sector meant that the simplification of the exchange rate system and greater availability of foreign exchange for imported inputs in 1986 allowed for the expansion of output thereafter, although the net effect of devaluation was dampened to a certain extent by the greater cost of imported inputs. However, with the gradual normalization of the economic situation in other Central American countries, intraregional exports expanded rapidly from 1990 to 1992, still within a relatively captive regional market.

There is no evidence of a drastic process of rationalization of the industrial sector as a result of the reduction of nominal protection and of its dispersion due to the 1986 tariff reform. Imports from non-Central American countries increased as a proportion of apparent consumption to levels (35 per cent in 1989) above those existing earlier (30 percent in 1978 and 26 percent in 1984). This sugests increased competition arising from imports, though possibly covering an expanding domestic demand rather than replacing domestic producers. The virtual elimination of quantative restrictions in 1986 and the significant weakening of the industrial sector during the first half of the 1980s, rather than the tariff reform, probably explain to a large degree the greater proportion of imports in domestic consumption of industrial products.

The greater growth rate of industrial value added from 1986 to 1992 (2.1 percent average per anum) appears associated (particularly in 1992) with increased domestic demand and with dynamic exports to the rest of Central America, rather than with increased industrial exports to the rest of the world. Whereas Guatemala's exports to Central America as a proportion of total exports had declined from 29 percent in 1980 to 17 percent in 1986, they increased to 30.5 percent in 1992. This suggests that the dynamism of Guatemala's traditional industrial sector continues to rely basically on a protected regional market, while its weight in total GDP continues to slip (table 3).

Table 3

Basic Indicators of Guatemala's Industrial Sector

	VA IND/GDP (%)	VA IND (growth rate)
1981	16.0	- 3.1
1982	16.0	- 5.2
1983	15.7	- 1.9
1984	15.9	0.4
1985	15.8	- 0.6
Average 1981-85	15.9	- 2.1
1986	15.9	0.6
1987	15.7	1.9
1988	15.4	2.3
1989	15.2	2.3
1990	15.0	2.2
1991	14.9	2.4
1992	14.6	3.1
Average 1986-92	15.2	2.1

Source: Own estimates based on data from the Banco de Guatemala.

Note : VAIND refers to Value Added by the Industrial Sector.

4.3 Past industrialization as an export platform

An important issue regarding past industrialization in Central America concerns the possibility of it providing the basis for exports to the rest of the world (Willmore 1989). Available evidence suggests that in Guatemala it may have done so in certain sectors though not in others. Specifically, the greater capital-intensity of several industrial sectors established to produce for the Central

American market, and their lack of backward linkages with the rest of the economy, has meant that they have not been able to benefit from Guatemala's natural comparative advantages associated with labour and natural resource availability. This factor and the absence of a demanding and competitive market have blocked the development of their international competitiveness. In other cases the industries' input requirements and Guatemala's relative factor availability have coincided, facilitating the development of competitive sectors.

Chemicals and equipment, which in Guatemala are among the two digit ISIC classification items (35 and 38) with the highest intra-Central American export/output ratios, would appear to fall within the first category (table 4). Both have significantly lower rest-of-the-world-export ratios.[4] On the other hand, wood products (33), textiles (32) and processed food (31), with greater degrees of backward linkages and higher labour intensities, have rest-of-the-world export ratios which are close to, or above, their corresponding intra-Central American ratios. In these cases either previously established plants or entrepreneurial experience could plausibly be behind the increasing industrial exports to the rest of the world. A gradual reduction of effective protection, complemented by other measures, ought to favour future investments in these sectors rather than in the former ones.

Furthermore, there are greater possibilities of generating additional value added when the backward linkages of some activities (arising from established but competitive industrial firms and from services providers, including tourism) can coincide with the forward linkages of others (including agroexporters). In these cases there would be a basis for improving the exporting and investment performance of a limited number of "clusters", to the extent that other determinants of competitiveness (Porter 1991, CEPAL 1990, Buitelaar and Fuentes 1990) could be strengthened.

[4] The relatively higher ratio corresponding to chemicals can be explained by the activity of TNE subsidiaries in pharmaceuticals, which first established in Guatemala because of its larger market, while expanding their exports to Central America, the Caribbean and other small South American countries. The process of production involved, however, is highly import intensive and its "final-touch" nature generates very limited employment effects.

Table 4

Export/output ratios in the industrial sector, 1989
(percentages)

SIIC		XCA/Y	XRW/Y
3.	Total industrial sector	9	6
31.	Foodstufs, beverages and tobacco	5	7
32.	Textiles, apparel and leather products	11	10
33.	Wood products	11	39
34.	Paper and printing	7	1
35.	Chemicals	15	6
36.	Non-metalic minerals	9	3
37.	Steel and iron, metals	7	4
38.	Machinery and equipment	11	4
39.	Other manufacturing	49	29

Source: Own estimates based on data from UNIDO and Bank of Guatemala. Y: production; RW: Rest of the world; CA: Central America; X: exports.

5. Systemic obstacles faced by exporters

The uncertainty relating to incentives arising from frequent modifications of legislation and from risks associated with exchange rate variability, together with defficiencies in technological difusion and infrastructural support, appear to be significant obstacles faced by exporters in Guatemala, which could halt the process of growing exports observed between 1987 and 1992. According to a survey of non-traditional exporters undertaken in the late 1980s, the main obstacles they faced were primarily supply and policy-related (CCI 1989, p. 53-5). On the one hand, they identified defficiencies both in terms of quality and volume of inputs and output, in addition to high energy and transport costs. On the other hand, they complained about the absence of clear incentives and expressed concern regarding the lack of adequate financial resources. Inadequate information about foreign markets and export procedures was also pointed out. In what follows attention is focused on some of these issues.

5.1 The performance of private investment

One indicator of the systemic obstacles faced by exporters is the performance of investment, specially private investment as a proxy of business expectations. Poor investment performance suggests that Guatemala's export expansion has not yet entered a sustainable phase. In several developing countries the significant decline in the overall investment GDP ratio during the 1980s has been explained in terms of a positive association of this ratio with output growth and public investment, and of a negative one with macroeconomic instability, deteriorating world economic conditions and foreign debt burdens (Serven and Solimano 1993). A similar situation would seem to apply to Guatemala, where the overall investment/GDP ratio reached approximately 20 per cent during the second half of the seventies and then fell to close to 11 per cent by the early 1990s.

More specifically, the private investment/GDP ratio fell from approximately 14 to 15 percent of GDP during most of the second half of the 1970s, to between 5 and 7 percent in the 1980s and early 1990s (table 5). No obvious trend is observable after 1986, in spite of growing exports. Negative output growth rates, falling public investment (see bellow), and instability related to political events and to the exchange rate can explain the negative growth rates of private investment during the first half of the 1980s and in 1990. And although growth rates of private investment were high in 1987, 1988 and 1991, the first year's (1987) can be interpreted as a once-and-for-all effect associated with a surge of imports of capital goods resulting from pent-up demand (see table 5), whereas the high growth rates of private investment in 1988 and 1991 are mostly the result of a boom in the construction sector, which in both years was the sector with the highest growth rate (18 and 9 percent, respectively) of the economy.

Moreover, credit conditions have not favoured investment in new export-oriented activities. In spite of repeated recommendations (CCI 1989, p.64-6), financial mechanisms or instruments specifically designed to favour non-traditional exporters have not been established, nor does a scheme of export credit guarrantees exist. The importance of this issue is highlighted by the fact that export credit is granted almost exclusively by commercial banks, known for their conservatism and the concentration of their loan portafolio (IPC 1991). Specifically, commercial banks have granted credit to exporters on equivalent terms to those involving production for the domestic market, and have favoured traditional exporters, their own stock holders or their traditional clients (CCI 1989, p.63). Furthermore, legislation has required guarrantees that new exporters can often not provide.

5.2 Education and technological difusion

Quality control and its relationship with technological difusion and education has proven to be a crucial issue. Specifically, under conditions which prevent widespread technological difusion, the larger the extent of linkages of an export activity with the rest of the economy (or the less "self-contained" it is) the less likely it would be for this activity to become competitive, since it would not benefit from modern techniques (Clague 1991). In other words, only assembly or enclave-type activities may be competitive in economies where technological difusion is very limited.

An example of non-traditional agroexports' vulnerability arising from a lower degree of "self-containment", and from greater reliance on locally provided inputs, would be the case of one of Guatemala's most successful non-traditional agroexports, the "Chinese pea". Specifically, it was temporarily barred entry into the US market in 1992 due to the excessive use of pesticides by small scale producers. In this case inadequate technological difusion can be attributed to lower levels of education. In general, difficulties in employing adequately trained workers and technical personnel has been a frequent complaint of exporting firms (CCI 1989, p.44).

Guatemala's clearly inadequate level of education, both in terms of coverage and quality, is linked to the existence of a weak public sector that cannot be understood without taking into account its weak taxation basis. Indeed, Guatemala is one of the countries with the lowest taxation ratios in the world. During the 1980s the tax ratio was kept bellow 10 per cent, having reached almost 5 per cent in 1984, in contrast to most Latin American countries, which at the end of the 1980s had a tax ratio between 13 and 20 per cent (CEPAL 1992a, p. 92).

Table 5

The evolution of private investment

	Private I/GDP (%)	Private I (growth rate)	IM-K goods (growth rate)
1980	7.2	-22.5	n.a.
1981	6.5	- 9.8	6.6
1982	6.6	- 1.5	2.1
1983	5.2	-23.6	-59.4
1984	5.3	2.6	26.3
1985	5.5	3.2	5.9
1986	5.7	3.7	8.4
1987	6.2	12.6	92.2
1988	6.7	12.2	6.7
1989	6.7	4.7	2.5
1990	5.8	-10.4	-10.7
1991	6.2	10.1	0.0

Source: Own estimates on the basis of data from the Banco de Guatemala.

Note: First two columns are based on constant prices. Third column is based on values in current US dollars. IM-K goods refers to imports of capital goods for industry, telecommunications and constructions.

Furthermore, during the 1980s a deteriorating economic situation coupled with a low tax ratio and with growing public employment in unproductive activities weakened further an already small and inefficient public sector. With a situation close to civil war during the first half of the 1980s, expenditures of the Central Government on defense and internal security increased from 12 per cent of the total budget in 1980 to 21 per cent in 1985, surpassing the proportion corresponding to education.

5.3 Public Infraestructure

Public investment fell continuously from 8.4 per cent of GDP in 1980 to 2.7 per cent in 1985 (table 6). Therafter it increased, though it grew at a lower rate than GDP from 1990 to 1992. Investment in roads, telecomunications and power during the first half of the 1980s illustrate both the problems faced by public investment in Guatemala, as well as the way these problems weakened, in latter years, the country's ability to develop its international competitiviness. Thus, in 1987 the World Bank stated that "two fifths of paved roads and three quarters of unpaved roads are now in poor condition, twice as high as comparable rates in Latin America" (World Bank 1987, p. 6). Furthermore, with 132 of Guatemala's 304 municipalities without any telecomunication services in 1988, and with approximately 60 per cent of unmet demand for telephone service in 1987, the delay of the national telecomunications agency's (GUATEL) 1984-87 investment plan further exacerbated the weakness of Guatemala's export infraestructure (World Bank 1987), apart from illustrating the serious problems arising from the public sector's limited executing capacity.[5]

Finally, the main project of hydropower (Chixoy), which absorbed approximately one third of total public investment between 1980 and 1985, and accounted for about 60 per cent of total generating capacity in 1990, suffered since its inception from a series of technical and financial problems, allegedly linked to corruption. These problems contributed to a complete breakdown of the system of electricity generation and distribution in the third quarter of 1991, when rain was lower than predicted, and gave rise to blackouts and severe rationing, estimated to have produced losses equivalent to 0.2% of GDP that year (SEGEPLAN 1992, p. 21).

The government elected in 1986 increased public investments (see table 6), though these were not directed to basic infraestructure nor to social sectors (SEGEPLAN 1992, p. 25-6). Furthermore, two fundamental problems remained. First, severely limited public sector saving continued to constrain public investment, which tended to depend on the availability of foreign funding.

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[5] A specific example of Guatemala's communications defficiencies linked to trade includes the situation of its main northern border post. Due to the increased importance of land transportation it is seen as a gateway of North America to Central America, but in fact involves a series of hurdles such as no import lots, a single and aging bridge connecting Mexico and Guatemala, and almost no telecomunications (The Journal of Commerce 1993).

Table 6

The evolution of public investment
(percentages)

	Public I/GDP	Public I (growth rate)
1980	6.7	n.a.
1981	8.4	33.6
1982	6.3	-20.1
1983	4.6	-33.3
1984	3.8	-25.5
1985	2.7	-20.3
1986	2.0	- 1.6
1987	2.8	24.2
1988	n.a	16.9
1989	3.6	12.3
1990	3.4	0.0
1991	3.2	5.9
1992	3.1	4.9

Source: Own estimates based on data from World Bank (1989) for 1980 to 1986 and from CEPAL for 19987 to 1992.

Secondly, the executing capacity of government agencies continued to be extremely limited. For example, in 1991 only 14 per cent of resources earmarked for investment in the health sector, and 50 per cent for education, were actually utilized that year (SEGEPLAN 1992, p. 35).

5.4 *The institutional framework*

The above is linked to the precarious institutional framework within which development has taken place. Regarding support for non-traditional exports, for instance, not only did the efficiency of the public sector in general deteriorate during the 1980s, but an agency of fundamental importance in promoting exports (GUATEXPRO), established in 1971, was closed down in 1983. This has been partly compensated by the Chamber of non-traditional exporters, which has been actively pressuring for the establishment of adequate domestic conditions for exports while simulatenously promoting the sale of their products in foreign markets.

More basically, however, during the 1960s and 1970s Guatemala benefitted from high rates of growth but experienced a continuous deterioration of rules, ranging from the respect of contracts to the most basic human rights. Without commonly accepted rules it became clearly impossible to build the social cohesion and cooperation required as part of the "systemic" nature of international competitiveness. Polarization resulting from extreme income inequalities and massive poverty have not favoured this process. But the degree of confrontation existing in Guatemala also weakened the country's exports of goods and services more directly, either because of the resulting uncertainty and its negative effects on national or foreign investment and tourism, or as a result of direct foreign government pressures to reduce market acces (e.g. threats to eliminate the US GSP) or official development assistance.

In fact, Guatemala provides clear examples of how an unusual degree of confrontation is ultimately self-defeating. Thus, a long history of workers' rights violations eventually led to an alliance of Guatemalan and US labour leaders which in 1992 was close to achieving the exclusion of Guatemalan exports from benefitting from preferences granted under the US GSP (Inforpress 1993). The resulting uncertainty was widely seen, among the private sector, as a reason for declining investment and exports in 1993.

Conclusions

Guatemala has undertaken significatnt stabilization and adjustment measures in ways that would not appear to differ significantly from processes of adjustment in other Latin American countries. However, the adjustment process in Guatemala appears to have taken place later than in most other countries in the region. Furthermore, a reactive, rather than a coherent long term strategy appears to have predominated, although the trend to stabilize and "get prices right" has been clear.

The most important instrument of adjustment during the 1980-92 period would appear to have been the exchange rate, which from 1986 to 1992 was maintained at a high real rate, although with significant variations within this period. Some progress has been made in eliminating anti-export biases in particular sectors through tariff exemptions for non-traditional exports, though its significant reduction for the economy as a whole only took place in 1993, when a revised Central American Common External Tariff was put in place.

However, Guatemala's extremely polarized society and the absence of a solid rules-based economic and social system, seen in the limited compliance with obligations established in contracts or in the violation of workers' rights, has been contrary to the social cohesion required by a sustained effort to develop the country's international competitiveness. Weak public sector institutions, insufficient public sector savings and limited executing capacity have also meant that physical infraestructure and public education have not kept up with the requirements of the Guatemalan economy's integration into a globalized and demanding world economy.

Thus, although non-traditional exports increased significantly from 1987 to 1992, mostly on the basis of competitiveness resulting from a significant real devaluation which reduced further the cost of low wages and natural resources, there is a danger that this process may not be sustainable. The virtual absence of a significant process of accumulation of capital on the part of the private sector, which should accompany growing exports, provides evidence for believing that this pessimistic outcome is possible and, indeed, likely.

The challenges faced by Guatemala are therefore daunting. Nevertheless, recent political events, resulting in the country's former human rights ombudsman being appointed President, suggest that the political and institutional framework required to develop social cohesion, which should increase the possibilities of developing sustained competitiveness, is being put in place. In this context more specific requirements, like improving infraestructure and establishing financial mechanisms to favour non-traditional exports, would not appear to face unsurmountable obstacles. However, other deeply entrenched obstacles, like the limited coverage and low quality of Guatemala's educational system and the country's low tax ratio, require solutions placed within a long-term perspective and as part of a well established development strategy based on a national consensus.

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