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TRADE AND INVESTMENT SECTOR PROGRAM

CONCEPT PAPER

**OFFICE OF TRADE AND INVESTMENT
USAID GUATEMALA**

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**TRADE AND INVESTMENT SECTOR PROGRAM
ASSISTANCE CONCEPT PAPER**

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I. PROGRAM SUMMARY

The purpose of this 5 year, \$25 million ESF/DA sector program is to increase trade and investment in Guatemala in support of the Mission's goal of achieving broad-based, sustainable economic growth within a stable, democratic society. The program combines a \$12 million policy reform component, carried out over two years, with \$13 million in project activities to be implemented over a three to five year period. The program supports a policy agenda jointly developed with the Government of Guatemala (GOG), the private sector, and the International Financial Institutions (IFIs). Project activities, designed to complement the policy agenda, are divided into three components crucial to developing the trade and investment sector: policy reform, business assistance, and direct trade and investment promotion. Project implementation will primarily target proven private sector entities, but also will provide some assistance to relevant public sector institutions.

A delegation of authority to the Director, Guatemala, is requested to authorize a \$25 million ESF/DA grant for the Trade and Investment Program.

II. BACKGROUND

Private investment and traditional exports have historically been the engines of growth in the Guatemala economy. In the early 1980s, however, Guatemala suffered a severe economic crisis. In part, this was attributable to inappropriate domestic policy responses to world recession and regional instability. More important, though, was the adoption two decades earlier of an industrialization strategy predicated upon import substitution. The distortions caused by these highly protectionist policies, combined with economic recession, resulted in a debilitated Guatemalan economy during this period.

In response to the economic problems that plagued Guatemala, a subsequent emphasis on short-term economic stabilization resulted in a significant improvement in the macroeconomic policy environment since the mid-1980s. An effective depreciation of the real exchange rate was achieved and inflationary pressures were restrained in all years, except 1990. On the regulatory side, tariff levels have been reduced, export procedures have been streamlined, and the national airline's monopoly on the cargo market has been eliminated.

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These initial reforms, taken by the Government of Guatemala to improve the macro-economic environment and support the productive capacity of the export sector, provide a basis for the current move toward open trade. In short, the macroeconomic policy framework is sound and in place. However, to continue its economic growth, Guatemala must now address the essential but more difficult second-generation sectoral policy, regulatory and institutional issues constraining further growth in trade and private investment.

III. RATIONALE FOR THE PROPOSED PROGRAM APPROACH

A. Mission Strategy

The Mission's goal is to support the achievement of broad-based, sustainable economic growth within a stable, democratic society in Guatemala. Expanded trade in globally competitive markets and increased private investment are considered principal means for achieving this goal. The achievement of short-term economic stabilization and an improved macroeconomic policy environment have resulted over the past five years in increased trade flows and investment in Guatemala as well as enhanced employment opportunities. Continuation of this strong economic performance will depend upon ensuring a competitive environment that provides proper incentives, encourages the free flow of technology and market information, and offers opportunities to all. Hence, the Mission has identified increased trade and private investment as one of its strategic objectives for achieving broad-based, sustainable growth.

The Mission's strategy over the past five years has been to strengthen and expand the Guatemalan private sector. However, interventions designed to strengthen the private sector are of limited utility if the policy environment is not conducive to increased trade and investment. Hence, USAID's strategy for the 1993-1997 planning period will focus more on eliminating the remaining policy, regulatory and institutional obstacles to increased trade and investment, while encouraging a vigorous response by the private sector to a more favorable policy environment. The impact of these reforms will be felt throughout the economy, promoting sustainable economic growth and increased participation on a broad base. Only then can real employment be generated and benefits realized by a significant portion of the population.

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USAID's in-country presence gives it a distinct advantage over other major donors in influencing policy reforms critical to developing an open trade regime and providing a sound investment climate. The timing of the new Trade and Investment Program is opportune for supporting the liberalization of Guatemala's trade and investment regimes, given the favorable policy orientation of the newly elected government, the present linkage and dialogue between the public and private sectors, and the USG's interest in promoting hemispheric free trade under the Enterprise for the Americas (EAI).

B. Major Constraints to Sector Development

In FY 91, the Mission undertook a study of the Constraints to Trade and Investment to assess the progress made in reforming trade and investment policies and those areas still requiring attention (see Annex A for USAID/Guatemala's publication, "Constraints to Trade and Investment in Guatemala"). This analysis is similar to that undertaken by the U.S. Government when examining the policy regimes of countries participating in the Trade and Investment Councils under the EAI. The preconditions of a Free Trade Agreement match these policy areas and serve as a basis for reforming the trade and investment climates in Guatemala. The reforms already taken by Guatemala are significant, and represent their commitment to free trade. Provided below are the remaining policy, regulatory and institutional constraints which must be addressed in order to attain an open trade regime and a sound investment climate. Removal of these constraints will permit an opening of the economy to competition from abroad as well as to fairer competition within.

1. Trade and Regulatory Reform

Although tariff barriers have been sharply reduced, they can be lowered further. The GOG should set a single rate for all commodities. Significant levels of effective protection exist when even small differences in tariff levels exist. For example, basic grains have significant negative effective protection. Tariffs on agricultural inputs range from 17 percent to 27 percent while the importation of basic grains is subject to only a 2 percent tariff. This structure provides a disincentive for the production and possible export of basic grains. In addition, the GOG prohibits the export of unprocessed coffee and regulates the import of wheat, wheat flour and cacao seeds. Such prohibitions are marginal but should be eliminated by the GOG.

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More binding constraints arise from the export and import licensing practices of the government. Licenses are required for the export of thirteen products including rice, beans and corn and for the import of twelve products including fertilizers, herbicides and insecticides. While the importation of certain environmentally dangerous herbicides and insecticides should be prohibited, normally, restrictions such as quotas and export licensing should be eliminated.

The tax code is another source of distortion. Existing fiscal incentive laws provide exemptions to specific enterprises producing a variety of items including bananas, fertilizers, and milk. A total of nine incentive laws remain in force. These laws not only affect the distribution of resources among sectors but, because they are given to specific enterprises, they affect resource distribution within sectors, as well. Subsidies for these types of economic activities should be eliminated.

Infrastructural deficiencies also constrain the trade and investment system in Guatemala. These constraints increase production and marketing costs, reduce product quality, and increase the time required for export. As exports continue to expand, infrastructural conditions will become major bottlenecks. Both public and private sectors can play larger roles in providing investment for infrastructural expansion and more efficient service delivery.

Demonopolization, particularly of critical public utilities, will serve to open and make more efficient trade and investment. At present, the Government of Guatemala operates a number of enterprises, including specialized banking and credit institutions, communications and transport companies, grain storage and trading, and electrical power facilities. With few exceptions, these enterprises represent a substantial drain on the GOG's fiscal resources. As government corporations, their activities are generally unresponsive to market signals with neither prices nor product distribution reflecting market demand. Perhaps the most serious problem with state-owned monopolies is that they prevent further expansion within these sectors by prohibiting private sector investment.

Finally, structural transformation of the economy -- sectoral shifts, changes in the role of trade, and increased scale of operations -- requires changes in the legal framework that economic institutions rely on to protect and allocate their resources, incentives, and information. Without legal democracy

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and a sound system of justice, benefits flow to rent-seekers rather than to free market-oriented entrepreneurs. Review and reform of the legal and regulatory framework will address such salient issues as the protection of intellectual property rights and workers' rights in Guatemala.

2. Financial Markets

Exporters and export associations indicate that the most binding constraint that remains to export activity is the weak and fragmented financial structure. The economic deterioration of the early 1980s and the world debt crisis is requiring a significant change in operation of the financial system. Guatemala can no longer depend solely on foreign resources to maintain economic growth. International capital to finance investments remains in short supply, a situation made more constraining by the host of new claimants (Eastern Europe and the Soviet Commonwealth) on international financial capital. Foreign commercial banks continue to reduce their exposure in developing countries, forcing developing countries to rely on the generation of domestic resources to finance critical investment spending. If domestic resources are not forthcoming, Guatemala will face decades of low per-capita growth and will fall far behind its Central American neighbors in trade and development.

The transformation of the financial system is now required in order to mobilize domestic resources.¹ Antiquated laws governing financial activities need to be modernized, information on the financial position of institutions needs to be standardized and made transparent, and regulations should ensure safety and efficiency rather than restricting the financial system as they do now. As a result of these changes, commercial banks will be able to increase the scope of their lending activities; providing a whole new range of instruments, including money markets, negotiable certificates of deposit and indexed savings instruments. As the supply of loan funds increases in the financial system, groups previously excluded from the financial system will gain access to credit.

¹ See Annex B for a more complete discussion of the needed reforms in the Guatemalan financial markets and a list of critical reforms that will form the basis for the agenda and policy dialogue.

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3. Technical, Human Resource and Institutional
Constraints

While a benign policy environment is a necessary condition to increased trade and investment, institutional, technological and human resource constraints impeding higher levels of investment and exports also exist. AID experience in trade and investment has shown that companies in developing countries often lack information and skills necessary to engage in profitable trading and investment activities. Local firms need training in increasing production and product quality; they require help in reorganizing product lines and guidance on how best to expand present operations and incorporate new products, and they frequently lack information about foreign markets and trading practices. Moreover, many companies have an inadequate technological base, and are forced to rely upon deficient infrastructure in transportation, energy and communications.

These obstacles must be overcome if Guatemalan businesses are to perform competitively in global markets. USAID will continue to support public sector institutions and a select number of private organizations that address these constraints and that have been successful in achieving specific policy reform and investment and export growth objectives.

C. Justification For Sector Program Assistance

The constraints identified above will be addressed through a sector program which combines both project and non-project assistance. This two-pronged approach has been selected as the most effective way for achieving the policy, regulatory and institutional reforms necessary for increased trade and investment in Guatemala. A discrete set of constraints will be the focus of policy-based cash transfer assistance for the first three years of the program. The policy agenda will, in turn, be reinforced through project activities designed to support and implement the proposed reforms.

D. Program Goal and Purpose

The goal of the Trade and Investment Sector Program is to support the achievement of broadly-based, sustainable economic growth in Guatemala within a stable, democratic society. Achievements of the program goal will be measured in terms of an increase in GDP, an increase in per capita GDP, and an increase in employment.

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The purpose of the T&I program is to increase trade and private investment in Guatemala. Accomplishment of this purpose assumes the existence and stability of sound macroeconomic policies on the part of the GOG. In order to increase trade and private investment, the Mission will direct its resources to achieving the following program outputs: 1) an open trade regime; 2) a sound investment climate; 3) the deepening of financial markets; and, 4) the increased production and marketing of non-traditional exports.

E. Expected Achievements and Accomplishments

By the Program Assistance Completion Date (PACD), the program will produce the following: 1) an increase in the value of non-traditional exports from an estimated \$420 million in 1992 to \$616 million in 1997; 2) an increase in trade (exports plus imports) from 52 percent of GDP in 1992 to 54 percent in 1997; and, 3) an increase in private investment from 12.8 percent of GDP in 1992 to 15 percent in 1997.

F. Project Outline and How It Will Work

The five year, US\$25 million sector program will be implemented through two assistance modalities: 1) \$12 million for non-project assistance to support policy and regulatory reforms; and, 2) \$13 million for project activities to complement and enhance the policy, legal and regulatory reform. Sections IV and V of this paper detail the preliminary plans for how the non-project assistance and project activities will address the existing constraints to sector development.

IV. POLICY-BASED NON-PROJECT ASSISTANCE

An essential part of this sector program is the policy-based cash transfer assistance. A total of \$12 million dollars will be disbursed against clearly defined policy reforms of the GOG that remove remaining constraints to trade and investment.

A. Defining Conditionality

Over the life of the program, A.I.D. will work with a ministerial-level working group to develop a policy agenda based upon the existing trade and investment constraints described above. On the GOG side, the working group will consist of the Ministers of the Economy, Agriculture, and Finance, and other public sector entities involved with trade and investment in Guatemala. On the USG side, the working group will include the chiefs of the offices

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of Trade and Investment, Rural Development, and Economic Analysis, the economic attache in the embassy and the A.I.D. project manager. The working group will adopt a strategic plan of policy actions essential to further liberalizing trade and investment in Guatemala. The development of this plan will be coordinated closely with the ongoing Trade and Investment Council negotiations and will be responsive to issues that arise from these discussions. Based on the targets of the strategic plan, the Mission will identify a set of specific policy reforms that will serve as the conditionality for program disbursements.

B. Coordination with Other Donors

The Mission has been working closely with the World Bank and the International Development Bank (IDB) as they develop a SAL for Guatemala to be jointly implemented by the two organizations. AID expects to be able to leverage its assistance and policy reform efforts with the IDB's resources that, under the SAL, will be directed at reform of financial markets. In addition, the Mission will continue to coordinate closely with the IDB as it defines the conditions and parameters of its Investment Sector Loan Program.

USAID's Trade and Investment Office has also maintained close contact with the UNDP as it develops its program on stabilization and economic growth, one of three focal areas under its proposed program.

C. Proposed Policy Reform Agenda

As indicated, the policy reforms against which dollars will be disbursed under this program will be defined in negotiation with the GOG. The negotiations will be based on the Mission's policy agenda presented below. The specific policy reforms and benchmarks against which progress is measured for year one of program implementation will be defined before the final review and authorization of the program document (PAAD). As indicated previously, the definition of policy reforms will be driven by the issues and actions arising from the recent Trade and Investment Council. The policy reforms and conditionality for disbursement for the second year will be defined in a PAAD amendment.

The Mission's policy agenda--based on the (1) Mission's ability to leverage reform within the two year time frame for policy dialogue, (2) the opportunity to take advantage of the GOG's predisposition now to enact specific trade and regulatory reforms, (3) the occasion to build upon the initiatives underway because of

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the Trade and Investment Council, and (4) the importance of reforms in a given area to improve the trade and investment environment--focuses on policy reform in two major areas, listed below in order of priority:

1. Legal and Regulatory Reform
2. Financial Market Reform

Given the confluence of events--a government open to liberalizing trade and investment and the initiation of Trade and Investment Council meetings--and because most of the reforms in this area can be effected by governmental decree, not requiring legislative action, legal and regulatory reform will be given priority in the policy agenda. Notwithstanding the importance of financial markets reform, the magnitude of reform in the latter area makes this a medium to long-term effort, one that can be initiated but not completed under this program.

C.1. Legal and Regulatory Reforms Promoting Transparency of the System

The list of policy objectives for the policy dialogue on legal and regulatory reform includes:

1. elimination of restrictions to trade, including trade licensing and permit requirements for imports and exports;
2. removal of all but minimum registration requirements on exports and imports leading to eventual elimination of the need for a one-stop export office;
3. elimination of fiscal incentive laws;
4. removing barriers to entry that limit private sector participation in transportation, the private provision of storage facilities at the airport, private participation in port management, concessions to the private sector for road maintenance, and elimination of monopolies in road transport;
5. removing barriers to entry that limit private sector participation in communications;

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6. encouraging private investment in generation, transmission and distribution of electricity;
7. modernization of the legal system regulating trade and investment, especially patent law and legislation regulating intellectual property rights, rules and regulations governing the employment of foreign managerial and technical personnel, laws regulating the importation of technology, tax policies and codes, and corporate, labor and antitrust law.

C.2. Financial Market Reform

The list of the policy objectives of the policy dialogue on financial market transformation includes:

1. standardization of accounting regulations;
2. standardization of audit procedures, including the requirement for periodic external audits of the banks;
3. revision of the company law and banking law to ensure that debtors and creditors are protected, no inconsistencies exist between the laws, and that modern financial activities are permitted;
4. modernization of the bankruptcy laws and identification of legal steps available to enforce solvency requirements by the Superintendency of Banks;
5. improvements in the Bank of Guatemala's capacity to monitor developments in the commercial banking system;
6. modernization of prudential regulations governing capital requirements, criteria for entry and exit from the financial system, regulations governing asset diversification, insider trading and creation of debt reserves for nonperforming loans; and
7. strengthening of the regulatory power of the Superintendency of Banks, ensuring that it has the information needed and the authority to enforce banking regulations.

The policy dialogue activities will seek to ensure that the various objectives of financial reform are understood. The

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tradeoffs between reforms that stimulate competition, efficiency and innovation on the one hand and stability, safety and fairness on the other will be explained. The objective will be to define clearly, for the financial system, the benefits of financial reform and to convince the private sector to work with the public sector to create a financial system that meets the needs of this decade.

One outcome of the negotiations over the financial reform will be agreement on a basic financial constitution. That understanding will include the structural, prudential, supervisory and legal considerations discussed above. Those conditions will govern what financial institutions do, where they can operate and what conditions they have to meet. The resulting clarity will enhance the competitiveness of the financial system and produce a significant increase in domestic resources channelled through the domestic financial system.

D. Use of Dollars and Local Currency

Following recent guidance from AID/W on the use of dollars, the Mission is exploring the possibility of creating a mechanism similar to the Eximbank Trade Credit Insurance Program (TCIP). The dollars disbursed under the Trade and Investment Sector Program would go into a separate audited account of the Bank of Guatemala to finance the same types of bank-to-bank letters of credit for imports of commodities from the United States supported under TCIP. While this mechanism would not function under the TCIP authorization nor serve as a guarantee fund, it would utilize the same certifications and documentation of source and origin employed under TCIP. End-use tracking of the dollars would also use the mechanism now in place under TCIP.

Local currency generations--supplied by local importers to finance dollar commercial transactions--will have two separate uses. One use (approximately \$U.S. 2 million in local currency equivalent) will be to support GOG institutions (e.g., the Ministry of Economy, the Bank of Guatemala and the Superintendency of Banks) actively promoting the trade and investment program reforms in legal and regulatory systems and in financial markets.

The remaining local currency generations, ten millions dollars equivalent, will be used to create an endowment for two private-sector based institutions--The Guild of Nontraditional Product Exports and the Investor's Service Center--that have successfully demonstrated over several years their ability to both promote policy reform from within and promote Guatemalan exports

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and investment potential. The endowment--ten million dollars equivalent in local currency--will be set up as a perpetual trust and invested in either Bank of Guatemala bonds or other high-interest-bearing financial paper, now earning between 18 to 22 percent annually. Both entities have sound and credible systems of accounting--with several years experience with U.S.A.I.D. requirements--making end-use tracking of local-currency-endowment interest generations an administratively straight forward and trouble-free process.

The decision to create an endowment for these two entities comes from recommendations provided in the PPC/CDIE study, Export Promotion and Investment Promotion: Sustainability and Effective Service Delivery (November, 1990). They found that core services provided by these institutions are already sustainable but that the development programs and services--the growth areas for the future--cannot and should not be financed by user fees.

It is the Mission's intention to withdraw all support for these organizations by the completion of the Trade and Investment Program. AID direct support to these organizations is programmed to be phased out in year four, putting the issue of sustainability to the test in year five, while the project is still underway. The creation of a one-time endowment, in conjunction with the present collection of user fees for standardized services, will permit the two organizations to become self-sustaining without sacrificing the development activities that have made them export and investment promotion models in Latin America today.

The two recipient organizations obviously fulfill the characteristics of the type of development organizations that have traditionally been AID endowment recipients.² They reflect high levels of organizational entrepreneurship, have demonstrated capability to exercise national leadership in forging public and private sector linkages, and ability to pursue aggressively export and investment promotion.

² See Terms of Endowment: A New A.I.D. Approach to Institutional Development, A.I.D. Evaluation Special Study (Draft), Hansen, Gary E., CDIE, Agency for International Development, July 1990.

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V. PROJECT ACTIVITIES

Project activities are designed to support the policy-reform agenda outlined above. The design of project activities follows the guidelines outlined in APRE's 1991 Trade and Investment Project Guidebook and draws upon lessons learned in export and investment promotion, as laid out in the recent PPC/CDIE study, Export Promotion and Investment Promotion: Sustainability and Effective Service Delivery, (November, 1990). The latter study, which included Guatemalan export and investment-promotion, private-sector organizations in its sample, concluded that the Guatemalan model, exemplified in the Guild of Nontraditional Product Exporters, was both effective in having impact and in developing a high degree of sustainability for core services.

Project activities will support three components: (1) policy reform support; (2) business assistance; and (3) direct trade and investment promotion. The project activities supporting public sector entities provide time (five years) for the public sector to respond with the necessary institutional and organizational changes that address the changes in the legal and regulatory environment affecting trade and investment. Project activities with the private sector are planned for a four year period to ensure that private sector activities capitalize on opportunities created by the adjustments.

A. Component 1 - Policy Reform Support

The purpose of the policy reform support component is to assist in the design and implementation of laws, policies, regulations and procedures that support private-sector-led export and investment growth. The focus of the component is to provide technical assistance and fund policy analysis in support of this purpose. Project activities under this component are designed to complement the policy-based agenda with activities linked specifically to the achievement of goals of the reform agenda. This component is divided into three subcomponents: (1) strengthening of relevant public sector entities; (2) provision of long and short-term technical assistance; and (3) strengthening private sector entities involved with trade and investment promotion, in the area of policy formulation.

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1. Strengthening of Relevant Public Sector Entities (\$2 million/5 years)

Approximately two million dollars equivalent in local currency generations will be provided to public sector entities (e.g., the Ministry of Economy, the Bank of Guatemala, and the Superintendency of Banks) to improve their capability to implement appropriate policy changes. In the public sector, the Ministry of Economy (MOE) is most directly involved with trade and investment. Within the MOE, the Office of Industrial Policy (OIP) takes the lead in promoting exports, employment and investment. In order to strengthen the MOE, this component will provide assistance to improve the MOE's capabilities to expedite export and investment procedures, to conduct negotiations with the U.S. (on the North American Free Trade Agreement, Bilateral Investment Treaty, and the Intellectual Property Rights Agreement, and other relevant issues), to strengthen participation in the GATT negotiations, and to negotiate with Mexico, Columbia, Venezuela, and other Central American countries. Funding will be provided for local technical assistance, policy studies and analysis, and limited commodities and supplies.

In addition, support will be provided through the MOE to CONAPEX, the umbrella private/public sector body advising on economic policy, to allow it to continue to facilitate consensus building between the two sectors. This assistance may include a Trade Specialist, support for external technical assistance and funding for commodities and miscellaneous supplies.

The Trade and Investment Sector Program will help the Bank of Guatemala (BOG) and the Superintendent of Banks (SB) to carry out policy studies and analysis and draw upon technical assistance to support the policy reforms to be carried out, to simplify the identification of constraints within the financial system and assist in the implementation of institutional reforms to be taken consistent with the policy reforms.

2. Long and Short-Term Technical Assistance (\$3 million/5 years)

A technical assistance team will be contracted to support the policy dialogue. Technical assistance and analyses will be provided to decision makers to ensure they have necessary information and factually supported recommendations to effectively influence policy.

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A three person technical assistance team will be contracted directly to provide the technical assistance necessary to support the policy agenda and trade and investment promotion. The chief of party will have expertise in commercial policy, legal and regulatory systems. A second member of the team will have technical expertise in financial markets, while the third will have joint responsibility for export and investment promotion. Approximately twelve months of short-term technical assistance will be provided in the broad area of privatization, and legal and regulatory systems (i.e., commercial policy) affecting trade.

3. Private Sector Institutional Strengthening (\$2.25 million/4 years)

The third subcomponent of the Policy-Reform-Support Component will focus on strengthening the policy formulation ability of private sector entities involved with trade and investment promotion. The purpose of this subcomponent is to assist in building consensus for change by supporting nongovernmental organizations that represent interests of private-sector exporters, investors, and business groups committed to market-oriented policies.

Two private sector organizations have emerged as leaders in this field -- the Chamber of Entrepreneurs (CAEM) and the Guild of Nontraditional Exporters (the Gremial). Assistance to CAEM will help maintain a dialogue through public fora with conservative groups within the private sector that are resisting the removal of protectionist policies. These two institutions will be given institutional support on a diminishing basis over four years to ensure their continued ability to carry out a policy negotiations with the government on behalf of their private sector membership.

Both organizations have received AID assistance in the past. AID will phase out direct assistance to both organizations by the end of year four of the program, putting to the test both institutions' strategies for financial sustainability. Both institutions are expected to continue operating the last year of the project, and thereafter, without further AID direct assistance.

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B. Component 2 - Business Assistance (\$1.5 million/3 years)

The second component of this project will focus on providing technical and business assistance to help firms engage in productive international trade and investment transactions. Technical assistance to Guatemalan businesses involved in trade and investment will be provided by the International Executive Service Corps (IESC) to CAEM and the Guild. The services provided by IESC include the technical assistance provided by Volunteer Executives (VES), drawing upon their own past experience as leaders of American industry and business.

Through CAEM, this component will support Guatemala's emerging industrial and manufacturing sector as it moves from a protective environment into a free market economy where it will have to become competitive in world markets. The component will support technical assistance in initiating industrial reconversion.

Under the Gremial, business assistance activities will include not only generalized technical assistance to specific exporting sectors of the economy to aid them in new market and product identification and in technology transfer to keep them competitive, but also a highly successful in-house training program for exporters and investors.

C. Component 3 - Direct Trade and Investment Promotion

Given Guatemala's potential for domestic and international investments and proven capability to export, investment and export promotion will make Guatemalan products and firms more competitive in world markets. Therefore, the third component of project activities will support and strengthen already proven private sector agencies now involved in investment and export promotion in Guatemala.

1. Export Promotion (Gremial - (\$3.25 million/4 years)

This component will assist the Non-traditional Products Exporter Guild maintain and further refine an active market information system, its export promotion and investment promotion efforts, and continue its role within CONAPEX and in public fora in promoting a public dialogue with the GOG around liberalized trade and investment issues.

Specific activities to be supported include the market information system and promotion of domestic trade fairs and

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participation in international trade fairs, and continued assistance to exporters in dealing with the ever changing international legal and regulatory environment.

2. Investment Promotion (CAEM - \$1 million/4 years)

Investment promotion activities in CAEM will be focused on the Investment Services Center (ISC). They will also strengthen a range of ancillary but important support services. The ISC prepares and disseminates promotional materials, provides referrals to inquiries, helps arrange agendas for visiting investors, and coordinates with other entities involved in investment promotion.

CAEM will receive assistance to help it think through alternative strategies and approaches to investment promotion and to select one that is both effective and sustainable over time. This assistance, in conjunction with the endowment that A.I.D. will set up with local currency generations, will be the last support provided by AID for these organizations. As discussed above, with the endowment and their own user-fee structures, these organizations will be wholly self-sufficient by the end of the project.

D. AID Management Support Requirements (\$1.2 million/3 years)

The Trade and Investment Sector Program will be managed out of the USAID/Guatemala's Trade and Investment Office. The day to day management of project activities and their coordination with the policy agenda will be contracted with a PSC Project Manager. The PSC Project Manager will be responsible for keeping in close touch with all project activities at the field level and keeping the Office of Trade and Investment's Chief informed of any project implementation problems.

The PSC Project Manager will have the additional support of one locally contracted financial analyst and one local contractor as an executive assistant. \$1.2 million in project funds are budgeted to support a PSC Project Manager and support staff and services over three years.

E. PROJECT EVALUATION AND IMPACT MEASUREMENT

The Trade and Investment Sector Program will provide all evaluation and monitoring for the Mission's Strategic Objective, Increased Private Investment and Trade. These functions will be

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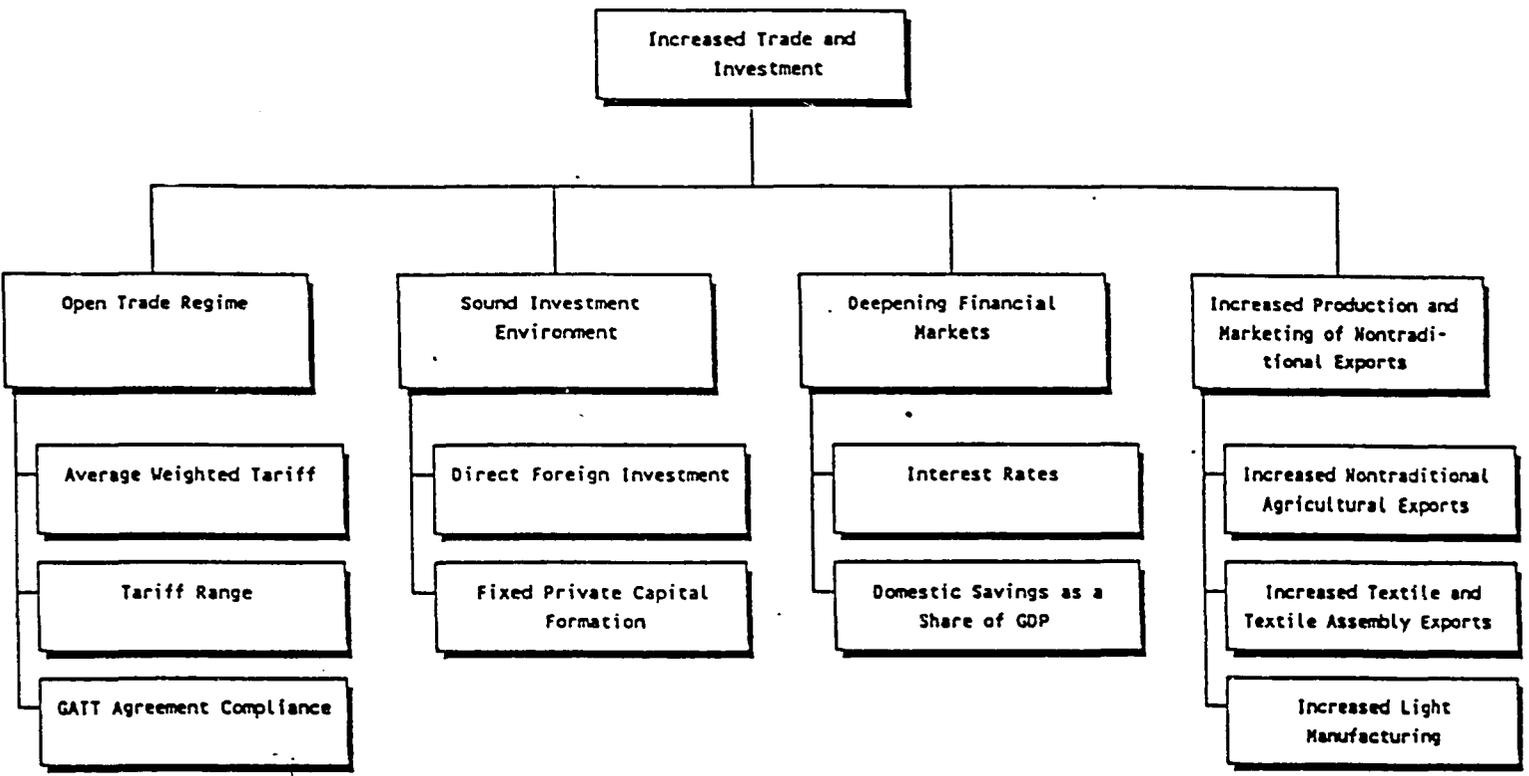
carried out through contracted evaluations and special studies and through the monitoring capabilities of the MIS installed in CAEM.

The design of the Trade and Investment Program will include a monitoring and evaluation component which will measure progress toward achievement of the purpose and program output indicators under the T&I program as well as under the other Mission projects contributing to the Trade and Investment strategic objective. Data from the ongoing INE and IFPRI surveys will be critical to establishing a baseline against which to measure ground level impact such as income and employment generation. In addition, special studies will be conducted during the program to assess the impact of the T&I program on the disadvantaged, on gender and on the environment. The general success of the program will take time to measure. Like education projects, the activities envisioned under this program will impact the sector over the medium and long-term.

Purpose and program output indicators have been established to measure successful implementation of the T&I Sector Program. At the purpose level, successful implementation will be measured by indicators for (1) increased value of nontraditional exports, (2) increased trade as a percentage of GDP, and (3) increased private investment as a share of GDP. A preliminary schema of the program output indicators is presented in Figure 1.

Support will be provided to update and maintain the Management Information System (MIS) now installed in CAEM to ensure information transfer runs smoothly and to enhance the information dissemination capabilities of the system. The MIS in CAEM will also be used to monitor program impact. This system was designed for and has the capacity to support AID program performance monitoring requirements.

FIGURE 1
PROGRAM OUTPUT INDICATORS



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VI. Estimated Costs and Methods of Financing

TABLE 1 TRADE AND INVESTMENT SECTOR PROGRAM PROJECT ASSISTANCE			
COMPONENT	ESTIMATED COST		METHOD OF FINANCING
	DOLLARS	LOCAL CURRENCY	
1. Policy Reform Support			
TA Team (3 persons/5 yr)	\$3,000,000		Aid direct contract
Public Sector Support (5yr)		\$2,000,000	HB 3 Grant
Institutional Strengthening			
Gremial (4 year)	\$1,750,000		Coop. Agree.
CAEM (4 year)	\$ 500,000		Coop. Agree.
SUBTOTAL	\$5,250,000		
2. Business Assistance (IESC - 3 year)			
Volunteer Executives	\$1,500,000		Coop. Agree.
SUBTOTAL	\$1,500,000		
3. Trade and Investment Promotion (4 years)			
Export Promo. (GREMIAL)	\$3,250,000		Coop. Agree.
Invest. Promo. (CAEM)	\$1,000,000		Coop. Agree.
SUBTOTAL	\$4,250,000		
4. Project Support (4 years)			
Project Management	\$1,200,000		Contract
5. Evaluations and Project Monitoring (MIS)			
	\$ 600,000		Contract
6. Contingencies			
	\$ 200,000		
SUBTOTAL	\$2,000,000		
PROJECT TOTAL	\$13 MILLION		

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TABLE 2		
TRADE AND INVESTMENT SECTOR PROGRAM		
TOTAL PROGRAM RESOURCES		
	DOLLARS	LOCAL CURRENCY COUNTERPART
NONPROJECT ASSIST.	\$12 MILLION	
--GOG PUBLIC SECTOR INSTIT.'S		\$2 MILLION EQUIVALENT L.C.
--ENDOWMENTS		\$10 MILLION EQUIVALENT L.C.
--GREMIAL		\$9 MILLION EQUIVALENT L.C.
--CAEM		\$1 MILLION EQUIVALENT L.C.
PROJECT ASSISTANCE	\$13 MILLION	
--GREMIAL	\$5.0 MILLION	\$2 MILLION L.C.
--CAEM	\$1.8 MILLION	\$.45 MILLION L.C.
--IESC	\$1.5 MILLION	\$.375 MILLION L.C.
--T.A. TEAM	\$3.0 MILLION	
--GOG Pub. Sector Inst's		\$.5 MILLION L.C.
TOTAL DOLLARS	\$25 MILLION	
TOTAL LOCAL CURRENCY GENERATIONS		\$12 MILLION
TOTAL PROJECT COUNTERPART		\$4.37 MILLION L.C.

VII. ANALYSIS OF IMPLEMENTING INSTITUTIONS

A. Public Sector

1. Ministry of the Economy

Most of the activities with the Ministry of Economy (MOE) are derived from its position as the leading public sector institution within the National Export Council (CONAPEX) and the important role it plays in defining trade and commercial policy. The project will support the various offices within the MOE exercising important roles in promoting exports, employment, and investment; including but not limited to the Office of Industrial Policy, the business register, patents and product register, CONAPEX and the Office of Foreign Business.

Although the MOE has begun emphasizing export development and liberalized trade regimes, existing staff are not well qualified to

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carry out the trade reforms and liberalized administrative procedures that will permit free trade and investment in Guatemala. Training will be provided to MOE staff to help them in conducting negotiations with the U.S. on the NAFTA and under the Framework Agreement and to address international pressure on Guatemala's position on Intellectual Property Rights and Worker's Rights Legislation and Enforcement. Support by USAID will be temporary and designed to ensure the proper implementation of new laws and reduced registration and commercial regulatory requirements. Assistance will be granted with the understanding that the GOG will increase its budgetary allocation over time until external assistance is no longer needed.

2. The Bank of Guatemala

The Bank of Guatemala has responsibility for design and implementation of monetary policy. The BOG must have sufficient analytical capacity and effective monetary instruments to carry out monetary policy. Although the analytical capacity of the BOG is better than most other public sector institutions in Guatemala, additional technical training is warranted. The BOG pays little attention now to developments in the commercial banking system. As this sector expands and becomes more complex, the quality and type of analysis carried out by the bank will have to improve.

3. The Superintendency of Banks

Since 1990, the Superintendency of Banks (S.B.) has struggled to improve the quality of its operations, particularly within the banking area. It has put into operation basic information systems, including operational manuals on accounting practices for all financial entities and information on reserve requirements. It also now provides regular reporting based on form E-73, a consolidated general balance report. Nevertheless, current institutional organization and work patterns in the Superintendency of Banks have not been revised to provide adequate management of its supervisory and information management functions.

With the planned reforms within the banking sector, and particularly with the increased supervisory requirements expected to be required under a new banking law, the S.B. will have to contract, train, and maintain a professional staff capable of handling modern information systems and put into operation new forms of bank supervision that maintain the S.B. at arms distance for commercial banks and enable it to carry out prudential

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regulation of banks, with external audits and standardized guidelines for bank examinations and performance reviews.

4. AID Certification of GOG Public Sector Accounting and Procurement Procedures

AID is currently working with the MOE under the PED project to institute the necessary accounting and procurement procedures to permit AID to certify these in late 1992. AID will be working with the BOG and the S.B. to certify their accounting and procurement procedures in late 1992.

B. Private Sector

1. The Chamber of Entrepreneurs (CAEM)

CAEM is a non-political, nonprofit organization, formed by the chambers and associations of the Guatemalan private sector (technically a "chamber of business chambers"). CAEM was founded in 1981 to capitalize on the benefits of the Caribbean Basin Initiative and to negotiate policies that accelerate economic development.

CAEM functions as a think tank and liaison organization between the GOG and the Guatemalan business community. CAEM focuses on policy analysis and advocacy; it also oversees the Investor Service Center (ISC). The ISC prepares and disseminates promotional materials, provides referrals to inquiries, helps arrange agendas for visiting investors, and coordinates with other entities involved in investment promotion.

2. Guild of Nontraditional Exporters (Gremial)

Hierarchically, the Gremial is one of many private sector organizations under CAEM. The Gremial is a nonprofit trade committee of the Chamber of Industry of Guatemala. It was founded in 1982 to develop and promote nontraditional exports in the agricultural and manufacturing sectors. The Gremial's promotional activities target both the micro and macro level. On the micro level, the Gremial provides services directly to exporters to develop and promote products through its sector-specific Commissions. On the macro level, the Gremial works with the GOG to encourage more favorable export policies and to encourage better infrastructure development. The Gremial serves as a voice for the collective opinion of its members.

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The Gremial serves the needs of its members through a hierarchical structure of commissions and subcommissions. All members participate in one of the five product-specific commissions (Agriculture, Furniture and Wood Products, Textile Assembly, Manufacturing, and Aquaculture). Each commission draws upon specialized assistance from four functional units (Promotion, Training and Technical Assistance, Information, and Projects).

The 60 staff members of the Gremial are divided into two units: an operational unit and a strategic unit. The operational unit provides support to the product-specific commissions. The strategic unit works with CONAPEX and houses the Transport Rate Negotiating Office. The program is represented in the United States by the commercial attaches in the Guatemalan embassies. In the mid-term evaluation for the Private Enterprise Development (PED) Project, the Gremial emerged as the best performing and best managed organization supported under the project.

3. International Executive Service Corps (IESC)

The IESC is an A.I.D.-registered U.S. PVO with extensive experience in implementing private enterprise development projects worldwide. The IESC has been working in Guatemala since 1967. An evaluation of IESC assistance to Guatemala over the past two years is currently being conducted and recommendations will be incorporated into the project design.

4. AID Certification of Private Sector Institutions' Accounting and Procurement Procedures

Both the Guild and CAEM have been working with AID to standardize their record and accounting procedures and expect to receive AID certification in April 1992. IESC is a registered U.S. PVO; it does not require certification of its accounting and procurement procedures because they are audited regularly in the U.S.

VIII. IDENTIFICATION OF BENEFICIARIES

The benefits of the trade and investment sector program are increased foreign exchange earnings for the GOG and increased employment security and wages for the population of Guatemala. Direct beneficiaries will be the firms and individual producers involved in the export and investment sectors who gain from improved technical skills and increased market competitiveness.

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Given the largely agricultural character of the Guatemalan export economy, direct beneficiaries include the thousands of small-scale farmers, such as the members of the cooperative Cuatro Pinos, who produce and process nontraditional agricultural crops for export. Other beneficiaries include workers in the export sector, both rural and urban, who benefit from the increased employment, improved working conditions, and higher wages and benefits.

Recent studies show that Guatemalan industries oriented toward export markets are labor intensive and prefer women to men as their primary source of labor. This is true for the textiles, clothing and electronics industries, and also in picking, processing and packing of nontraditional agricultural products.³ Although reliable employment data is difficult to obtain, conservative estimates of the number of new jobs created for which women will be employed are on the order of 50,000 during the life of the project.

IX. DESIGN STRATEGY

This Sector Program Concept Paper represents the preliminary thinking of the Mission in designing a five year trade and investment program. During the next four months, several design activities are planned to refine this program in preparation of the final Program Document (PAAD). During project design, technical assistance will be brought in to assist the Mission in the following areas:

1. to review trade policies, to identify and rank key constraints, and to develop a policy agenda for the program.
2. to analyze legal and regulatory constraints to trade and investment and prioritize proposed interventions.
3. to provide project design assistance in investment promotion and analysis of institutional and regulatory constraints to foreign and domestic investment.

³ See Alberti, Amalia M., Impact of Participation in NonTraditional Agricultural Export Production on the Employment, Income, and Quality of Life of Women in Guatemala, Honduras, and Costa Rica. A report submitted to Regional Office for Central America and Panama (ROCAP). USAID, Guatemala City, Guatemala. April, 1991.

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4. to carry out the requisite social, economic, and political feasibility analyses of the policy reform program and studies of gender and environmental impact.

An analysis of the Guatemalan financial sector is currently underway and will be pivotal to the design of this aspect of the Trade and Investment Program. A five to six member, multidisciplinary design team will provide assistance in design of this trade and investment program. The team will consist of a trade economist, a legal and regulatory analyst, a specialist in financial markets, a socio-political analyst and an organizational specialist. The latter will help develop strategies for each of the participating private sector entities to achieve financial self-sufficiency by the PACD. This specialist will also develop strategies to assist AID in phasing out its assistance while causing the least possible disruption in operations of the recipient institutions. The Mission may also request assistance in design of the proposed endowments to ensure their smooth operation within the Guatemalan legal system.

The LAC/TI and LAC/DI technical support projects may be good sources for this assistance, but other R&D buy-ins or appropriate IQCs will be explored.

The Mission requests that Washington delegate authority to the Mission for approval and authorization of the PAAD and the subsequent PAAD amendment.

X. MISSION CONCERNS AND ISSUES

A. Resource Requirements - The program anticipates total resources of \$25 million, including \$12 million for policy-based disbursements. Lower ESF levels will force a narrowing of the focus of policy conditionality and a shortening of the time-frame of the policy dialogue. It is the Mission's intention to retain some policy component in the program, even at significantly reduced total funding levels.

B. Lack of an IMF Arrangement

During the 1991 Action Plan, the Mission said that it would not pursue a Trade and Investment Program if an IMF arrangement with the GOG was not in place. At that point, inflation was accelerating and the international reserve position of the Bank of Guatemala (BOG) was deteriorating. The requirement for an IMF

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program served as a proxy for the adoption of stable macroeconomic policies.

The newly-elected government that took office in January 1991 effectively stabilized the economy without an IMF program. In 1991, inflation was reduced to 10 percent and dollar holdings of the BOG increased by \$500 million. Discussions with the IMF now focus on the establishment of a medium-term growth strategy.

The Mission believes that the lack of an IMF program at this time does not pose a threat to the initiation of the Trade and Investment Program. The economic team is not expected to change its policy stance and begin overheating the economy. Furthermore, an IMF program is expected to be signed in mid-year. Reflecting the underlying stability of short-term macroeconomic conditions, that IMF program will focus on the medium-term growth strategy of the GOG. The Mission believes that the Trade and Investment Program supports those efforts at achieving economic growth.

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ANNEX A:
CONSTRAINTS TO TRADE AND INVESTMENT PAPER

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DISCUSSION PAPER

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CONSTRAINTS TO TRADE & INVESTMENT IN GUATEMALA

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THE PROMOTION OF TRADE AND INVESTMENT IN GUATEMALA

A. Introduction

Private investment and trade have always been the primary factors in the growth of Guatemala's economy. Historically, the welfare of the country has centered on traditional exports and on private investment (public investment playing only a minor role). The original purpose of this paper was to highlight policy constraints to trade and investment in Guatemala. The evaluation carried out identified few such constraints for trade. Additional work needs to be done on policies that constrain investment. The paper is composed of three sections: (1) a description of the achievements already accomplished, (2) an outline of reform requirements already identified and, (3) a summary of areas where additional information and action is needed.

Small-scale industries are growing rapidly and playing an increasingly important role in determining economic activity. Given the small scale of the Central American markets, however, such businesses must expand into export activities if their importance in economic activities is to increase.

According to Management Systems International (MSI), a consulting firm specializing in the analysis of private sector activities, successful businessmen are constantly on the lookout for "the angle", they are risk takers, quick to identify failure and move into new lines of business. These entrepreneurs do not need subsidies or special treatment.^{1/} What they require most is (1) information necessary to identify opportunities, (2) opportunity to acquire sufficient know-how (technology and market information) and (3) access to resources (capital) that will allow them to undertake new activities.

^{1/} Some argue that government assistance is necessary if non-traditional exporters are to be successful. Support for that position is drawn from the experience of the Asian Tigers. It must be remembered, however, that these countries' governments assisted the most by reducing barriers to trade and creating conditions that allowed exports to thrive. Clearly, there was active government intervention, but the quality of these governments must be kept in mind. Government assistance alone will not work. A vigorous private sector is the key to any country's development. However, a vigorous private sector is not created "sui generis", but is the product of an active development program.

Public sector production of goods and services is generally to be avoided due primarily to the lack of responsiveness to market signals. The public sector must ensure that the appropriate policy environment exists within which entrepreneurs can flourish. Seven broad activities are appropriate for the public sector:

1. keeping the macroeconomic environment stable, particularly inflation and the exchange rate;
2. simplifying the regulations and restrictions involved in the export process;
3. promoting savings mobilization and expansion of the financial system;
4. providing adequate and appropriate infrastructure (transportation, energy, and telecommunications);
5. encouraging the privatization of various public industries;
6. improving technological and human resource development at all levels; and
7. modernizing the laws governing intellectual and physical property contracts, incorporations, labor relations, etc.

B. Progress to Date

The macroeconomic policy environment in Guatemala has improved since the mid-1980s. An effective depreciation of the real exchange rate was achieved (see Appendix A), and inflationary pressures were restrained in all years except 1990 (see Appendix B). On the regulatory side, the GOG implemented a series of major tariff reforms (the tariff range fell from 0-150 percent to 2-37 percent and the average weighted tariff fell from almost 30 percent to 14 percent), it shifted the tariff system from specific values to an ad valorem basis, and it effectively has eliminated the export tax (see Appendix C). The GOG also streamlined export procedures, creating a one-stop export center to facilitate export registration.

In the late 1980s, international air transport services were inadequate to accommodate the rapid growth of air cargo. The GOG eliminated AVIATECA's monopoly on the cargo market in Guatemala and international airlines quickly expanded services and increased the number of cargo flights. Cargo capacity in 1990 was more than adequate to meet the demands of exporters.

As a result of these efforts, private sector investment increased from 8.4 percent of GDP in 1986 to 12.5 percent in 1990--the second highest level in Latin America after Jamaica. The increase in investment and the improved export climate had a favorable effect on trade flows to the United States. During the last five years, the share of private investment and trade (exports plus imports) averaged 48.9 percent of GDP (see Appendix D), with non-traditional exports gaining increased momentum.

Non-traditional exports include agricultural and manufactured goods, primarily exported outside the Central American Common Market (CACM). Non-traditional exports from Guatemala to the United States grew at an annual average rate of 37.6 percent during 1983-1990, faster than any other Central American country and second only to Jamaica in Latin America. ^{2/} The average share of non-traditional products in total exports climbed from 5.7 percent in 1966-70 to 16.8 percent in 1985-89 (see Appendix E).

This surge in non-traditional exports suggests a shift in the structure of production. While improvements in the macroeconomic environment have allowed freer market forces to create new opportunities, institutional factors have also been important. Enabling legislation for assembly operations ("maquila") and the creation of outward-looking business groups have been instrumental in the evolution of, investment into and growth of Guatemala's productive trade sector. For this new pattern of production and trade to work efficiently, the Government must continue to embrace and improve upon a comprehensive set of market-oriented policies.

C. Remaining Policy Agenda

1. Macroeconomic Policies

Remaining constraints and barriers to free trade-- tariffs, regulations, foreign exchange controls--should be reduced or eliminated within a context of stable macroeconomic policies in order for trade growth to expand. In recent years, the performance of the government in this area has been incipient. The private sector has restricted investments to relatively

^{2/} Although Dominica and Grenada had faster increases than either Guatemala and Jamaica, the absolute levels were so small that they are excluded from most data bases.

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secure activities. Nevertheless, the steady depreciation of the exchange rate and elimination of export taxes have given appropriate signals to non-traditional exporters. As an economic stabilization program with the IMF is completed, private sector confidence in the maintenance of appropriate policies should improve.

2. Trade and Regulatory Reform

Few major restrictions limiting trade and investment remain. Major impediments--price controls, excessive registration of exports, fixed interest rates and tariff barriers--have been removed or are currently being targeted for removal. However, some specific trade and tax regulations remain.

Although the tariff barriers have been sharply reduced, they can be lowered further. The GOG should set a single rate for all commodities. Significant levels of effective protection can exist when even small differences in tariff levels exist. For example, basic grains have a significant negative effective protection--tariffs on agricultural inputs are 17 percent or 27 percent while the import of basic grains is subject to only a 2 percent tariff. This structure provides a disincentive for the production and possible export of basic grains. The GOG should set a single, unified tariff rate.

The GOG prohibits the export of unprocessed coffee and regulates the import of wheat, wheat flour and cacao seeds. Such prohibitions are marginal but should be eliminated by the GOG.

More binding constraints arise from the export and import licensing practices of the government. Licenses are required for the export of thirteen products including rice, beans and corn and for the import of twelve products including fertilizers, herbicides and insecticides (see Appendix F for a complete list). While the importation of certain environmentally dangerous herbicides and insecticides should be prohibited, in general such restrictions, including quotas and export rights, should be eliminated.

The tax code is a second source of distortion. Existing fiscal incentive laws provide exemptions to specific enterprises producing a variety of items including bananas, fertilizers, and milk. A total of nine incentive laws remain in force (see Appendix G). These laws not only affect the distribution of resources among sectors but, because they are given to specific enterprises, they affect intra-sectoral resource distribution. Subsidies for these types of economic activities should be eliminated.

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Interest costs are deductible for companies in the present tax code and interest earned by individuals is tax exempt. Dividend payments are taxable for companies, listed as profits, but when they are passed to individuals they are exempt. This combination provides an incentive for debt financing of activities and increases the demand for credit. While elimination of the interest deductibility for business borrowers, particularly exporters, would place them at a competitive disadvantage with producers in other countries where such deductibility is allowed, there is little justification for not taxing interest as income to lenders. A continued partial exemption for dividends received by investors would provide an incentive for equity investment.

The value added tax (IVA) is currently withheld from exporters' earnings, contrary to what was decreed in Law 60-87. The withheld IVA should be returned to exporters, since it represents a loss of working capital. Items imported for drawback production (maquila) should not be treated as final imports. The customs service should be professionalized, aiming towards efficiency and clarity. The present conditions at customs, even with the one-stop window, are causing bottlenecks. Further, immigration procedures for foreign investors, technicians, and businessmen should be streamlined, especially with regard to obtaining work permits.

Even if market signals are correct and financial resources are available for investors, lack of information can restrict export activity. Exporters must be aware of restrictions to market entry arising from such things as phytosanitary controls, quality and grade restrictions and other non-tariff barriers to entry. Export associations provide a convenient institution for providing such information.

These regulatory and tax issues result in some distortion but do not pose binding constraints to the expansion of non-traditional exports. The GOG, however, should not consider the removal of such constraints a minor matter. In order to strengthen private sector confidence in the permanence of the present outward orientation of the government, the GOG should:

- a. eliminate virtually all restrictions on trade;
- b. identify a negotiation process with the private sector that would permit movement, over time, towards a unified, single tariff rate within the context of industrial reconversion and the gradual removal of protective tariffs;
- c. remove all but minimum registration requirements on exports and eliminate the need for even a one-stop export office; and,

- d. open the foreign exchange market to the commercial banks by eliminating foreign exchange surrender requirements.

Such a sweeping elimination of regulations would indicate that the government will not reverse the open orientation of its policy stance.

3. Financial Market Reform

Exporters and export associations indicate that the most binding constraint that remains to export activity is the lack of finance. Small-scale exporters with an order for a large quantity of goods cannot get access to the most basic financial instruments such as letters of credit, lines of credit and revolving credit facilities. The difficulty is that savings mobilization by the Guatemalan financial system is low. Savers prefer to hold their wealth either in the form of fixed assets, such as land, or in the form of off-shore deposits. As a result, credit is scarce and capital is tied up in unproductive fixed assets. Informal financial markets provide some relief to exporters, but credit is often expensive and has very short maturities.

The reluctance of private savers to hold quetzal-denominated assets in the banking system results from a variety of factors. Throughout most of the period from 1986-1990, interest rates were fixed by the GOG at negative real levels. This policy discouraged savings and weakened lending institutions. While the policy was changed early in 1991, it will still be some time before the perceptions of Guatemalan savers change sufficiently for the full impact of the policy change to be felt.

A second factor is a lack of confidence in the soundness of the system. Some banks are believed to be insolvent and neither the Bank of Guatemala nor the Superintendency of Banks has the ability to fully monitor the banking system. A third factor is the shortage of savings instruments. NOW accounts, equity financing and other financial innovations are not available in the Guatemalan system.

Needed changes in the financial market include (1) making interest rate movements freer, (2) improving bank supervision and (3) increasing the number of financial instruments in the market.

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4. Infrastructural Constraints

Infrastructural constraints increase the operational costs, reduce product quality, and increase the time required for export. Current exporters have adapted to the actual situation - either taking advantage of availability or filling the gaps with their own resources. However, if exports continue to expand, infrastructural conditions will begin to pose binding constraints. Both the public and private sectors can play larger roles in providing investment and improved efficiency in infrastructural expansion and quality of service.

Infrastructural improvements are needed in a variety of areas including transportation, communications and energy. The role of the government is to ensure a minimum level of quality service. The principal policy issue is the barriers to entry that limit private sector participation.

While cargo capacity has been increased to meet the current demands, the airport still lacks cold-storage holding facilities. Many exporters have lost perishable goods when expected flights were cancelled. This need has already stimulated an expansion of merchandise handling by the private sector. Adequate storage facilities at the airport are essential.

The port system--Puerto Quetzal, Puerto Barrios and Santo Tomas--is inefficient. As a result, transportation and storage costs for Guatemalan exporters are significantly above those of exporters from neighboring countries. The GOG is beginning to address this issue by granting the private sector an increasing role in the operation of the port system. Private sector container operations and stevedore services have been authorized. Greatly expanded private sector participation in port management will be necessary if the system's efficiency is to be significantly improved.

The road system is in need of substantial repairs. Travel time has increased in recent years because of deterioration of major roads. Investment by the public sector has been delayed by the restrictive fiscal policy followed by the GOG over the last two years. At the same time, at least one study indicates that there are significant barriers to entry to the trucking/bussing system. As a result, there may not be sufficient competition to keep inland transport prices under control. The GOG should be urged to improve and maintain the road system and, at the same time, eliminate all monopolies in the transportation system.

In addition to high inland transportation costs, low economies of scale, port inefficiencies and inadequate storage facilities combine to make transportation costs from Guatemala to Miami almost twice those of Chile to Miami. The GOG should expand private sector participation in the transportation system and provide incentives for competition.

Electrical power demand for the country this year will approach 497 MW, with an estimated annual increase in demand of 7% a year projected for the period 1991 -- 1999. The sudden 20 percent shortfall in overall generating capacity, producing the current situation of power rationing and scheduled power outages, has rapidly raised electrical energy to the single most important constraint to production and exports now affecting the country. Although there exists an installed capacity of 788 MW, even under normal rainfall and water reservoir levels most of the thermal and hydroelectric plants of the Sistema Nacional Interconectado (SNI) operate far below capacity. This is primarily due to aging equipment, poor maintenance, and operational problems. The unexpected drought and the low level of Chixoy reservoir will further exacerbate the already low efficiency level, affecting energy availability and reliability well into the future.

To solve this problem, the GOG should move forward rapidly with current initiatives to encourage private investment in the generation, transmission and distribution of electricity. Private investment regulations should be clarified and investment guarantees provided. The GOG should also explore other solutions to demonopolize the energy sector. These should include the promotion of new electrical generation projects, assistance in securing financing for these projects, co-generation and interconnection of electrical systems across national borders.

5. Privatization

The Government of Guatemala operates a number of enterprises including specialized banking and credit institutions, communications and transport companies, grain storage and trading, electric power facilities, etc. With few exceptions, these enterprises represent a substantial drain on the GOG's fiscal resources. As government corporations, their activities are generally unresponsive to market signals with neither prices nor product distribution reflecting market demand. The cost and inefficiency of government enterprises has become well known. Perhaps the most serious problem with state owned enterprises is that either by fiat or preference, they prevent private sector investment. The barriers to private sector entry and the opportunities offered by privatization are areas that should be investigated.

Privatization offers a significant vehicle for attracting foreign investment, particularly if one or more of the four larger state-owned enterprises (e.g. GUATEL, INDE, EEGSA, and FEGUA) are offered for sale. The importance of foreign investment in these areas is that it would bring with it badly needed new technology that would greatly increase the efficiency of the systems involved and assure improvements in both the quality and quantity of services essential to the growth and competitiveness of the Guatemalan private sector.

6. Human Resource and Technological Development

An educated and skilled work force is essential for economic development, as is an environment in which technological change can be fostered to increase efficiency and returns on investments. Recent studies on the determinants of growth in Guatemala indicate that education has been a key factor in economic growth and development, that returns are high, but that the level of education and training continues to be relatively low.

Technological change is a major ingredient to moving along the development path. There needs to be clearer roles for the private and public sectors, in technological and human development. Each has a role to promote technological change, foster education, create conditions that encourage investment, reduce the risks of innovation, protect intellectual property rights, provide basic research support, and facilitate means for technology transfer and application.

7. Modernization of Legal System

The structural transformation of an economy -- sectoral shifts, changes in the role of trade, increased scale of operations -- requires changes in the legal framework in which economic institutions allocate their resources, incentives, and information. Without legal democracy and a sound system of justice, benefits tend to flow to rent-seekers rather than to free-market-oriented entrepreneurs.

While it is clear that there is room for improvement in much of Guatemala's legal system, additional studies are needed to focus attention on those changes most critical to expansion of international trade and facilitation of additional investment, both foreign and domestic. Pertinent areas for study include patent laws, rules and regulations governing the employment of foreign managerial and technical personnel; laws related to the importation of technology; corporate, labor and anti-trust laws; and tax policies and codes, particularly those providing for differential treatment of foreign investors, either as individuals or companies.

The GOG has made significant strides in eliminating distortions and disincentives that affect trade flows in

Guatemala. Little is known, however, about disincentives and distortions affecting flows of direct foreign investment (DFI). One area that exists is the tax treatment of dividend payments by firms. If a Guatemalan firm pays dividends to a Guatemalan stock holder, taxes on those dividends are the responsibility of the taxpayer. If dividends are paid by a foreign-owned firm located in Guatemala, the firm must withhold taxes due and pay those withheld taxes to the Ministry of Finance. The stockholder then declares the full value of the dividend and the withholdings already paid to the Ministry of Finance.

The impact of this differential dividend tax levy on DFI operations is marginal because of the many means available for circumventing this kind of tax regulation. There remains the question, nevertheless, of the existence of other regulations having the potential to negatively affect the decision to invest in Guatemala. For example, areas that still require further analysis for potential negative impact on foreign investment include:

1. the labor code,
2. other tax regulations,
3. trademark regulations or intellectual property issues.

Ways must also be found to expedite legal actions and decisions. In a dynamic and evolving private sector, the uncertainties inherent in a system that all too often require years for an important legal decision to be reached can be a powerful disincentive for otherwise viable and important economic ventures.

D. What Else Do We Need to Know and Do?

1. Financial System

There is considerable information on the conditions and restraints in the financial system. Special attention must be paid to the requirements needed to make interest rate movements freer, improve bank supervision, and increase the number of financial instruments in the market. That information must be systematically gathered and analyzed to identify policy areas, especially those restricting the creation of domestic and foreign savings and access to credit.

2. Infrastructure & Privatization

The policy constraints and the restrictions to private sector participation in infrastructure servicing need to be examined. Barriers to entry and monopolies existing in the trans-

portation system and in the port system are not fully identified. Opportunities for privatization, and how it would increase the efficiency of services and make the acquisition of new technology possible should be studied and be presented to the private sector and the GOG. The Guatemalan private sector should stimulate further studies and other activities that keep privatization in public view and at the center of the government's action agenda.

3. Foreign Investment and Technology

Entrepreneurs need access to technology, production know-how and marketing information. The most successful non-traditional exporters have gained such information through some combination of joint ventures or close relationships with suppliers in the United States market. Direct foreign investors can play a critical role in providing such information. Differential treatment of local and foreign investors has been addressed above, but needs to be researched further. Additional information is needed on regulations governing joint ventures and direct foreign investment.

The roles of both the public and private sectors in supporting education and research and development is essential for improving labor productivity and to foster innovative capital investment. Legal and institutional change is needed to create a suitable environment necessary for technological innovations. Information is needed on the legal and financial barriers preventing the implementation of mechanisms for the transfer of technology and the creation of legal constructs for foreign investment.

4. Modernization of Corporate Law and Regulations

Regulations governing property rights--physical and intellectual--and means for administering justice are unclear. There is a critical need to examine and possibly modernize the laws governing contracts, incorporations, antitrust, labor, etc. The laws concerning patents, the hiring of foreigners, transfer of technology, and taxes, require analyzing. Also, a further examination of the steps for business incorporation and in the use of protected technology is needed. This area will become increasingly important as non-traditional activities expand further from agriculture into electronics and manufacturing for export markets.

5. The Role of the Private Sector in Promotion and Development of Exports

The Guatemalan private sector has played a critical role in articulating to the GOG the policy reforms that needed to be undertaken during the last several years. The success of this dialogue, carried out in conjunction with the assistance of donor programs and pressure for macro-economic policy reform,

is measured by the presence of relatively few serious policy constraints to trade. The private sector has not been content, however, to merely address the policy constraints to trade and investment.

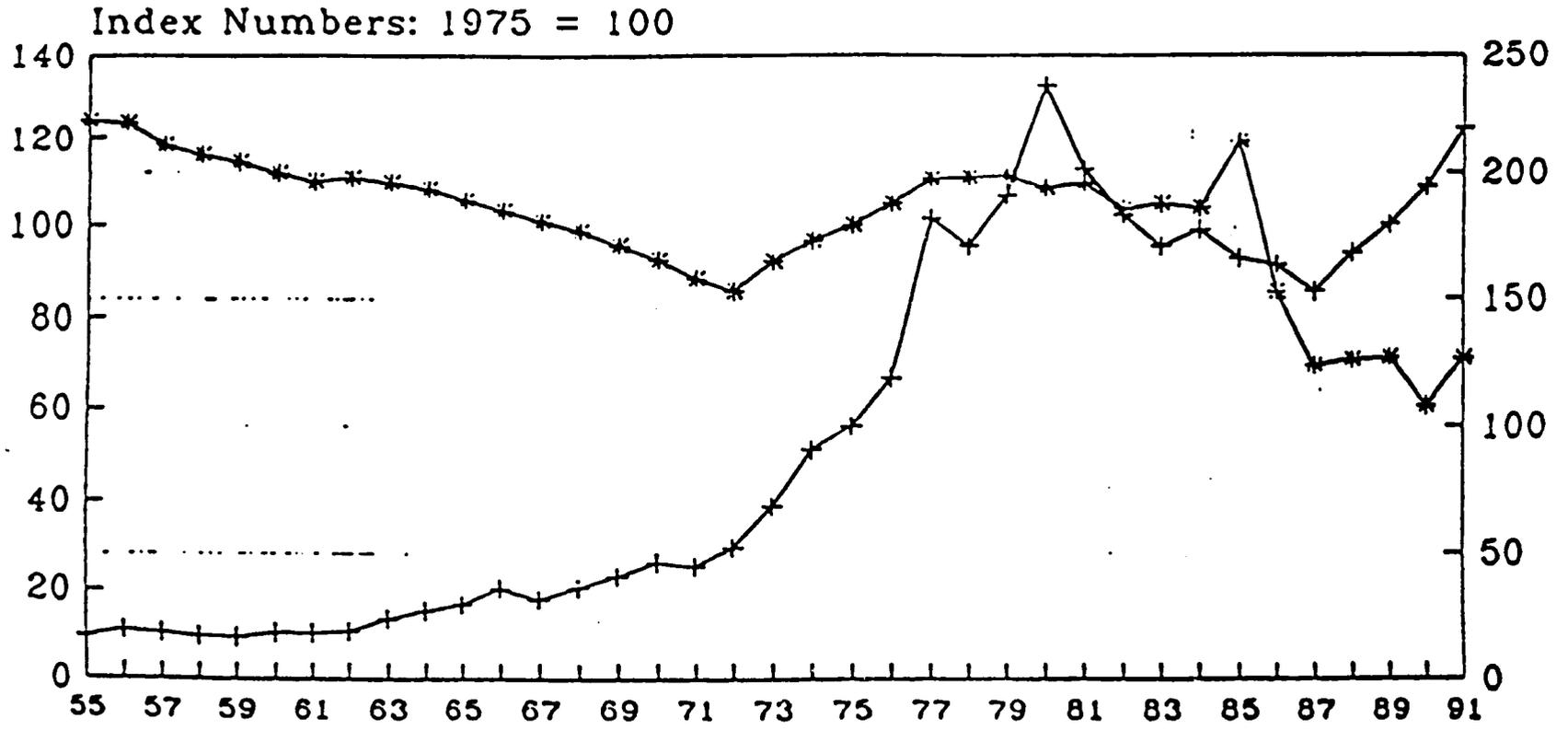
In the current competitive world markets, achieving the proper set of macro-economic policies is a "sine qua non" for entrance into the market place but, "per se", contributes little to aggressively establishing a competitive position therein. Recognizing this situation, the Guatemalan private sector has also taken a vigorously proactive stance on the removal of bureaucratic, institutional and regulatory constraints to trade and investment. This has been complemented by parallel efforts to stimulate investments, to diversify markets, and to promote and further develop exports. Although significant progress has been made in both areas, the highly fluid nature of local institutional development, the rapidly changing international market system, and the phenomenon of exploding growth in the export sector itself have created a lengthy agenda of actions still to be undertaken to maintain and improve Guatemala's position in world markets.

This agenda, still in process of definition and refinement, covers five broad areas of needed action. These five areas are:

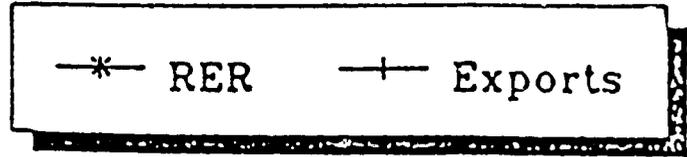
1. Promotion and Development of Exports
2. Investment promotion
3. Industrial reconversion
4. Strengthening local public and private institutional capacity to ensure compliance of Guatemalan exports with the international-market regulatory environment
5. Revision or elimination, where possible, of domestic non-tariff-barrier type regulatory measures that constrain growth and development of exports.

Real Exchange Rate & Exports

Guatemala: 1955 - 1991

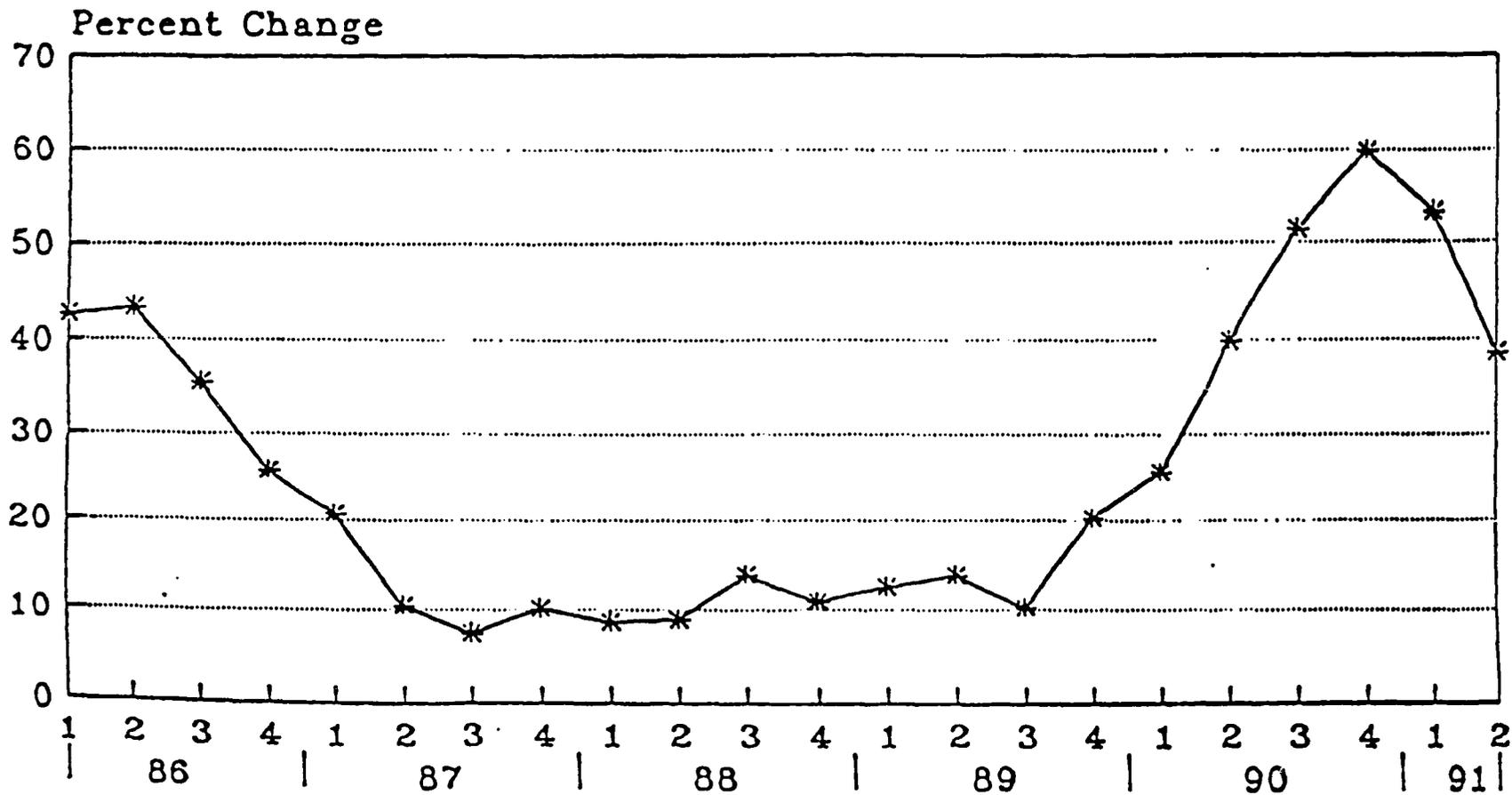


Lower index implies depreciation; higher index, appreciation

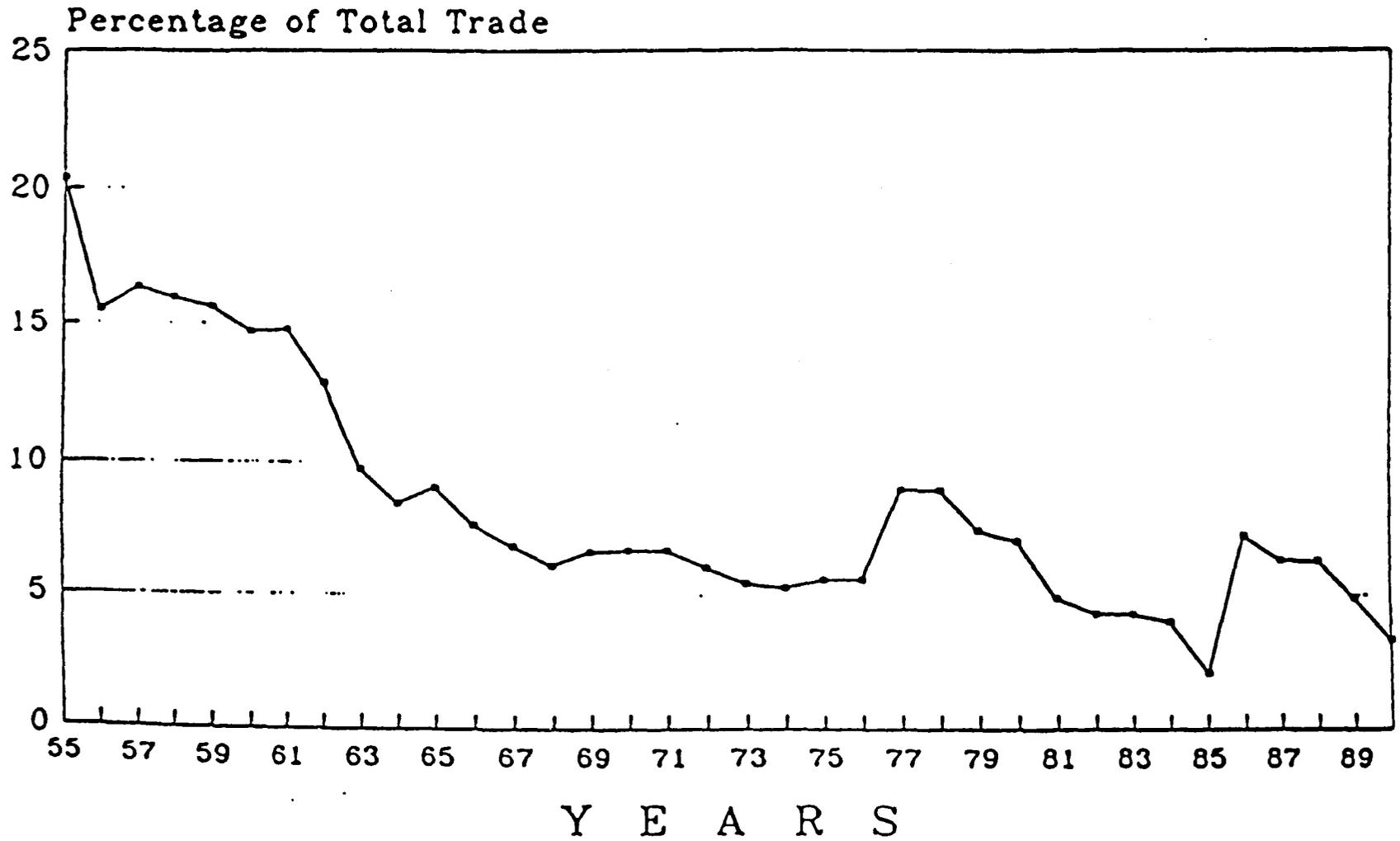


APPENDIX A

Guatemala: Inflation 1986 - 1991 (12-Month Inflation) Capital City

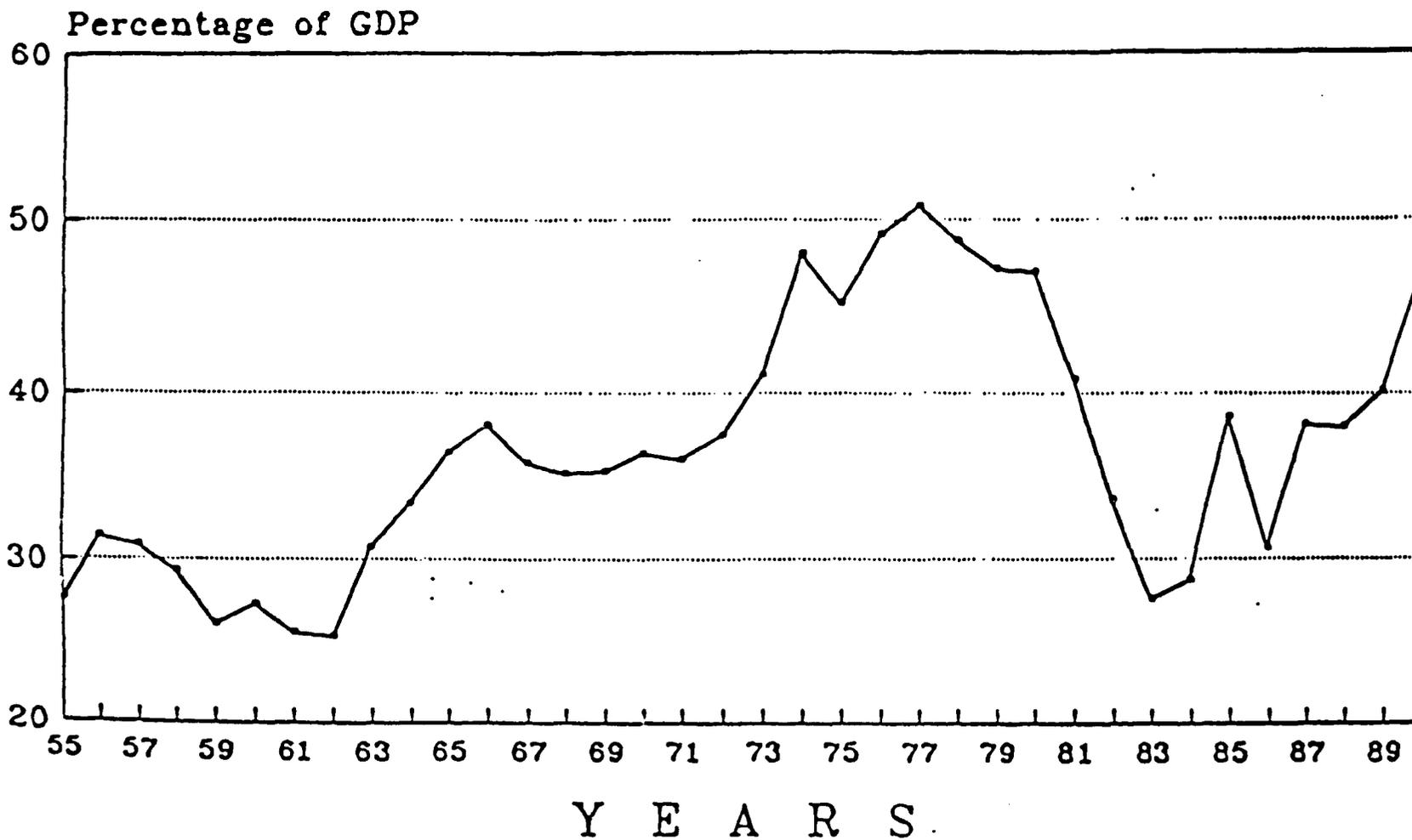


Real Tax Rate on Foreign Trade
Guatemala: 1955 - 1990



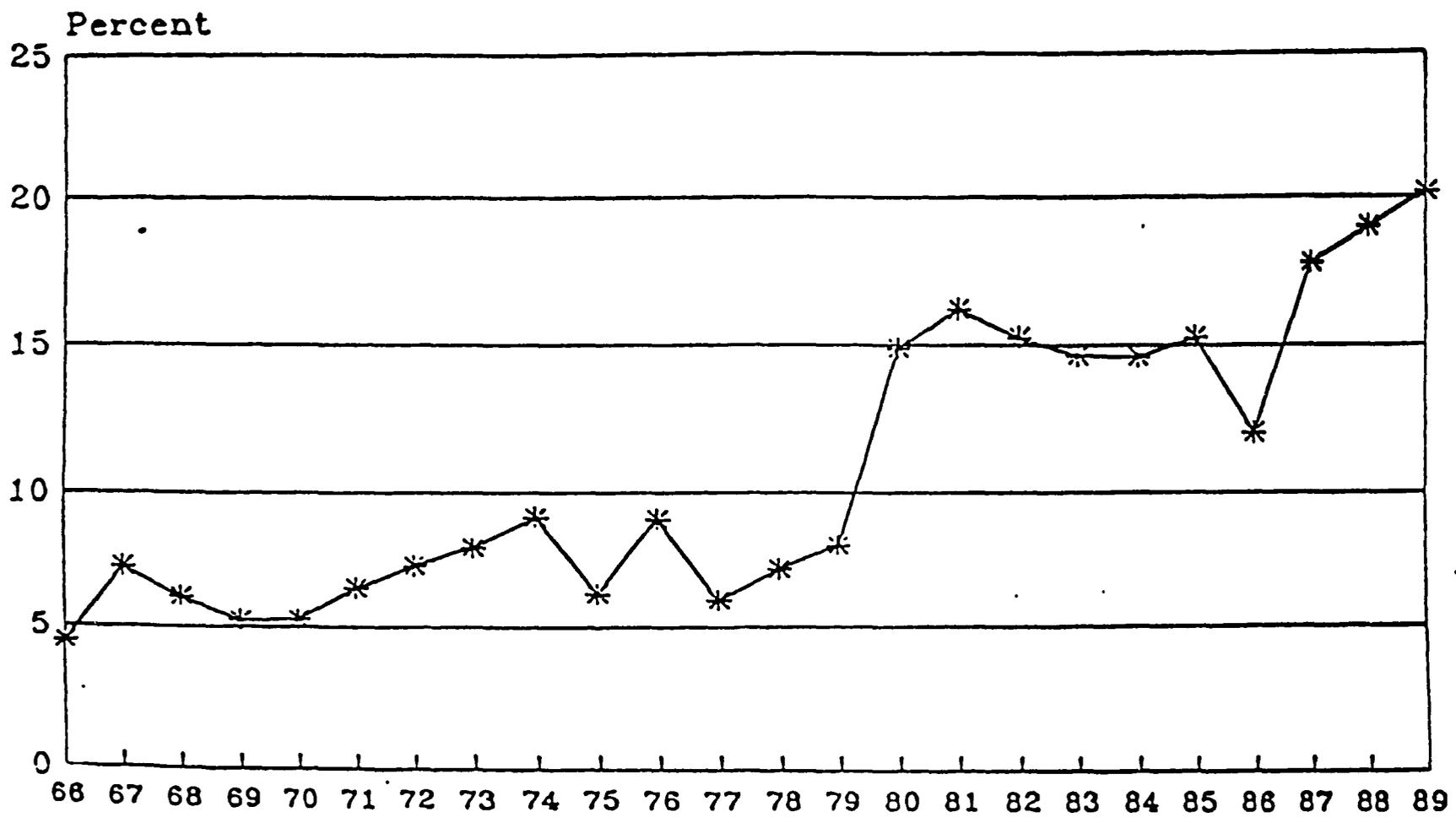
APPENDIX C

Share of Exports plus Imports Guatemala: 1955 - 1990



APPENDIX D

Non-Traditional Exports (As a Percent of Total Exports)



Guatemala: 1966 - 1989

APPENDIX E

APPENDIX F

NON TARIFF BARRIERS

1. Prohibitions

- a. Export
unprocessed coffee
- b. Import
wheat
wheat flour
cacao seeds

2. Licensing

a. Exports

- 1. cotton and cotton seeds (Controlled by association of growers/exporters)
- 2. sugar (controlled by Guatemalan Sugar Growers Association)
- 3. coffee (controlled by ANACAFE)
- 4. cacao
- 5. cardamom
- 6. beans

- 7. rice
- 8. corn
- 9. cut flowers
- 10. peanuts
- 11. sunflower seeds
- 12. clothing
- 13. electronics

b. Imports

- 1. fertilizers
- 2. herbicides
- 3. insecticides
- 4. flour
- 5. beans
- 6. corn
- 7. rice
- 8. peanuts
- 9. cotton
- 10. reproductive cattle
- 11. animal feed
- 12. medicines for animals

APPENDIX G

TAX INCENTIVES

1. All fiscal incentive laws are granted selectively to firms and are not sector-wide incentives.
2. Fiscal incentives laws for industrial decentralization, poultry and rubber were eliminated in February 1991.
3. Fiscal incentive laws remain for:
 - 3.1 Free Zones (zona franca)
 - 3.2 Maquila (draw back) industries
 - 3.3 Rabbit production (Law 89-71)
 - 3.4 Reforestation (Law 72-73)
 - 3.5 Cattle breeding
 - 3.6 Bananas
 - 3.7 Insecticides
 - 3.8 Fungicides and herbicides
 - 3.9 Fertilizers

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ANNEX B:
A DISCUSSION OF GUATEMALAN FINANCIAL MARKETS REFORM

Financial Markets--Changing the Rules of the Game

Historical Perspective

Before the 1980s, development of the financial system in Guatemala was based largely on the provision of short-term trade financing and working capital finance. Commercial banks were few in number and relatively small. Financial requirements for investment were met either through foreign borrowing or through retained earnings of the large corporations.

The governments of this period recognized that the financial system was not generating significant resources for the small and medium-sized firms. In response, public sector development banks, such as BANDESA and CORFINA, were created to mobilize domestic resources and channel those resources to targeted sectors of the economy. Government regulation of these specialized institutions was extensive. Credit was allocated by sector--usually to the agricultural and small-manufacturing sectors--and interest rates were controlled.

These policies resulted in an extremely weak and fragmented financial structure. As interest rates were frequently negative in real terms, there were few incentives for domestic savings. The wealthy held resources either abroad or in fixed assets such as land. The principal activity of the commercial banking system was to on-lend Bank of Guatemala credit and credit provided by foreign banks. By the end of the 1970s, for example, total foreign credit amounted to almost three-fourths of total financial system credit.

What Needs to Change in the Financial System?

The economic deterioration of the early 1980s and the world debt crisis has forced a significant change on the operations of the financial system. Guatemala can no longer depend on foreign resources to maintain economic growth. Instead, the banking system must attract domestic savings and then provide those resources for high-yield investments. If domestic resources are not forthcoming, Guatemala will face decades of low per capita growth and will fall far behind its Central American neighbors in terms of trade and development.

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The objective of the financial component of the Trade and Investment Program is to assist in the transformation of the financial system. Laws governing financial activities will be modernized, information on the financial position of institutions will be standardized and made transparent and regulations will ensure safety and efficiency rather than restricting the economic activities of the financial system. Commercial banks will be able to increase the scope of their lending activities, providing a whole new range of instrument such as money markets, negotiable certificates of deposit, and indexed savings instruments. As the supply of loan funds increases in the financial system, groups previously excluded from the financial system will gain access to credit. The Mission can play an important catalytic role in this transformation.

How to Get There

The transformation of the financial system requires a variety of reforms. First, the macroeconomic conditions must be stable. Second, there must exist a modern and effective information system ensuring that the financial system is transparent. Third, the legal structure must ensure the efficient functioning of a modern system. Finally, there must be in place an effective regulatory environment.

The stable macroeconomic environment is a necessary condition for the successful transformation of the financial system. No system can expand under conditions of accelerating inflation and wide-spread uncertainty. The GOG is expected to sign a stand-by agreement with the IMF in 1992, ensuring an appropriate climate for financial sector reform.

An efficient information system is essential for the functioning of a financial system. Financial institutions must be able to evaluate the expected risk and return of investments. Depositors must be assured that financial institutions are solvent. Consistent and timely information is needed in order to make those choices. This information base arises from appropriate accounting practices, auditing and information disclosure requirements. In Guatemala, there is no uniform accounting regulations that ensure that such information exists; instead, information is scarce and of poor quality. There are no regulations covering external auditing of financial institutions. As a result, audits are not considered reliable. In this area, policies governing comparability and reliability of information will be addressed.

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The existence of an adequate legal structure is the third requirement for an efficient financial system. There must be legal protection for both debtors and creditors. In Guatemala, the company law, the banking and securities law and the bankruptcy laws are outmoded. The Superintendency of Banks cannot monitor banking system activity and has no power to force changes of individual bank behavior. Furthermore, the laws are difficult to enforce. In order that financial contracts flourish and expand in scope, corporate laws, banking laws and securities laws must be updated. As the transformation of the system may put a number of banks under considerable stress, the bankruptcy laws will be of prime concern. The Bank of Guatemala and the Superintendency of Banks must have to tools and the authority to enforce bank closing and bank mergers when necessary.

A fourth requirement is the existence of an adequate regulatory system. As the financial system is transformed, the rules of the game are modified. New activities are encouraged and some, more traditional activities are discouraged. The objective of regulatory reform is to ensure that the transformed system is safe and efficient, mobilizes resources efficiently and minimizes mistakes in resource allocation, curbs fraud and prevents instability from turning crisis. Regulatory reform embodies (1) development of appropriate prudential controls and (2) the strengthening of bank supervision.

Prudential controls seeks to reduce the risk of systemic failure and avoid the development of a financial crisis. Institutions are required to be adequately capitalized, professionally managed, have diversified risks and have adequate accounting standards. In recent years, there has emerged a consensus on a variety of such prudential regulations including capital requirements, criteria for entry and exit, on the appropriate degree of asset diversification, on limits on loan to insiders and on providing capital reserves for non-performing loans. These regulations in Guatemala are outdated and unenforced. A revision of the existing standards and the degree of reform needed will be a central focus in the initial phase of the program.

Sound prudential regulations must be complemented with a system of effective supervision. Supervision ensures that commercial banks comply with the rules and regulations, that losses are not hidden from the public and that adequate steps are adopted to prevent the emergence of a full-blown financial crisis. Supervision also involves the establishment of mechanisms to deal

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with insolvent institutions. If the private sector is to begin channeling savings through the financial system, it needs to be assured that the bankruptcy of one institution does not threaten the entire financial system.

Role of Policy Dialogue

The transformation of the financial system is politically difficult. Groups that have earned substantial wealth will be in jeopardy; groups traditionally excluded from the political arena may begin to gain power and influence. Political leadership and guidance during this transition become extremely important.

To be effective, the political leadership requires a thorough understanding of the costs and benefits of the transition. Understanding the rationale for removing some regulations and restrictions and the necessity of introducing others is essential for the design of an effective program of financial reform.

The policy dialogue activities will seek to ensure that the various objectives of financial reform are understood. The tradeoffs between reforms that stimulate competition, efficiency and innovation on the one hand and stability, safety and fairness on the other will be explained. The objective will be to define clearly the benefits to the financial system of financial reform and convince the private sector to work together with the public sector to establish a financial system that meets the needs of this decade.

One outcome of the negotiations over the financial reform will be agreement on a basic financial constitution. That understanding will include the structural, prudential, supervisory and legal considerations discussed above. Those conditions will govern what financial institutions are permitted to do, where they can operate and what conditions they have to meet. The resulting clarity is expected to enhance the competitiveness of the financial system and facilitate a significant increase in domestic resources channelled through the domestic financial system.

A summary of the policy objects of the policy dialogue on financial market transformation could include:

1. standardization of accounting regulations;
2. standardization of audit procedures, including the requirement for periodic external audits of the banks;

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3. revision of the company law and banking law to ensure that debtors and creditors are protected, no inconsistencies exist between the laws, and that modern financial activities are permitted;
4. modernization of the bankruptcy laws and identification of legal steps available to enforce solvency requirements by the Superintendency of Banks;
5. improvements in the Bank of Guatemala capacity to monitor developments in the commercial banking system;
6. modernization of prudential regulations governing capital requirements, criteria for entry and exit from the financial system, regulations governing asset diversification, insider trading and providing capital reserves for non-performing loans; and
7. strengthening of the regulatory power of the Superintendency of Banks, ensuring that it has the information needed and the authority to enforce banking regulations.

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ANNEX C:
PROGRAM INDICATORS AND IMPACT MEASUREMENT

The Mission is proposing three indicators to measure the impact of the Trade and Investment Program: (1) increased value of nontraditional exports, (2) increased trade as a percent of GDP, and (3) increased private sector investment as a percent of GDP. An adequate baseline exists for these indicators and there exists a relationship between the objectives of the Trade and Investment Program and those indicators. Equally importantly, there exists an important linkage between the indicators chosen and economic well being of the poorest Guatemalans.

Increased value of nontraditional exports

Nontraditional exports have grown at an average annual rate of over 20 percent between 1985 and 1991. The bulk of these exports are provided by small-scale farmers living in the Guatemalan Highlands. This activity has drawn families hitherto excluded from the market into the monetized economy. As nontraditional growth expands, such small-scale farmers will be the group most likely to benefit.

Increased trade as a percent of GDP

One of the difficulties affecting the Central American economies in the past was the development of industries and activities that were costly and inefficient. Scarce domestic resources were used in areas where the returns were small and the benefits to the economy small. The end result of these policies included inflation, bankruptcy of the public sector and unemployment.

The opening of the economy to international trade and international competition has several objectives. Foreign technology flows into the economy via imports and direct foreign investment. Demand for exports increases, allowing greater and more efficient use of resources. This increase in overall activities benefits everyone in an economy. However, domestic labor is used more intensively in domestic production than other inputs. Therefore, the labor groups of an economy benefit most from increased trade. Their opportunities grow more rapidly and their wages increase at a faster pace than similar labor groups in closed economies.

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Private investment as a percent of GDP

The opening of the economy will provide new opportunities for private sector activity. Guatemala's comparative advantage lies in labor-intensive activities. Private sector investment will increase in those areas that are relatively labor intensive. Examples include nontraditional agricultural exports, "maquila" and small-scale manufacturing. The increase in private sector investment will bring with it increased employment and increased wages.

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**ANNEX D:
INITIAL IEE**

ENVIRONMENTAL THRESHOLD DECISION

Project Location: Guatemala
Project Title: Trade & Investment Sector Program
Project Number: 520-
Funding: \$25 Million
Life of Project: Five years
IEE Prepared by: Alfred Nakatsuma
USAID/Guatemala
Recommended Threshold Decision: Categorical Exclusion
Bureau Threshold Decision: Concur with Recommendation
Comments: None
Copy to: Terrence J. Brown, Director
USAID/Guatemala
Copy to: Elizabeth Warfield,
USAID/Guatemala
Copy to: Alfred Nakatsuma, USAID/Guatemala
Copy to: Wayne Williams, REMS/CEN
Copy to: Mark Silverman, LAC/DR/CEN
Copy to: IEE File

_____ Date _____
John O. Wilson
Deputy Environmental Officer
Bureau for Latin America
and the Caribbean



INITIAL ENVIRONMENTAL EXAMINATION

Project Location: Guatemala
Project Title: Trade & Investment Sector Program
Funding: \$25 Million

Program Summary

The purpose of this 5 year, \$25 million ESF/DA sector program is to increase trade and investment in Guatemala in support of the Mission's goal of achieving broad-based, sustainable economic growth within a stable, democratic society. The program combines a \$12 million policy reform component, carried out over three years, with \$13 million in project activities to be implemented over a three to five year period. The program supports a policy agenda jointly developed with the Government of Guatemala (GOG), the private sector, and the International Financial Institutions (IFIs). Project activities, designed to complement the policy agenda, are divided into three components crucial to developing the trade and investment sector: policy reform, business assistance, and direct trade and investment promotion. Project implementation will primarily target proven private sector entities, but also will provide some assistance to relevant public sector institutions.

Program Goal and Purpose

The goal of the Trade and Investment Sector Program is to support the achievement of broadly-based, sustainable economic growth in Guatemala within a stable, democratic society. Achievements of the program goal will be measured in terms of an increase in GDP growth, an increase in per capita GDP growth, and an increase in employment.

The purpose of the T&I program is to increase trade and private investment in Guatemala. Accomplishment of this purpose assumes the existence and stability of sound macroeconomic policies on the part of the GOG. In order to increase trade and private investment, the Mission will direct its resources to achieving the following program outputs: 1) an open trade regime; 2) a sound investment climate; 3) the deepening of financial markets; and, 4) the increased production and marketing of non-traditional exports.

A brief description of the comments is provided below:

Component 1 - Policy Reform Support

The purpose of the policy reform support component is to assist in the design and implementation of laws, policies, regulations and procedures that support private-sector-led export and investment growth. The focus of the component is to provide technical assistance and fund policy research and analysis in support of this purpose. Project activities under this component are designed to complement the policy-based agenda with activities linked specifically to the achievement of goals of the reform agenda. This component is divided into three subcomponents: (1) strengthening public sector entities; (2) provision of a long and short-term technical assistance pool; and (3) strengthening private sector entities involved with trade and investment promotion, in the area of policy formulation.

Component 2 - Business Assistance (\$1.5 million/3 years)

The second component of this project will focus on providing technical and business assistance to help firms engage in productive international trade and investment transactions. Technical assistance to Guatemalan businesses involved in trade and investment will be provided by the International Executive Service Corps (IESC) to Entrepreneurial Chamber (CAEM) and the Non Traditional Exporters Guild. The services provided by IESC include the technical assistance provided by Volunteer Executives (VEs), drawing upon their own past experience as leaders of American industry and business.

Component 3 - Direct Trade and Investment Promotion

Given Guatemala's potential for domestic and international investments and proven capability to export, investment and export promotion will make Guatemalan products and firms more competitive in world markets. Therefore, the third component of project activities will support and strengthen already proven private sector agencies now involved in investment and export promotion in Guatemala.

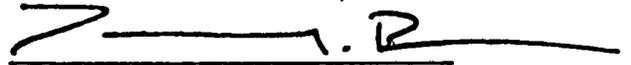
Environmental Impact

The proposed project will not involve activities that have an effect on the natural and physical environment. The activities which will be carried out qualify for a categorical exclusion according to Section 216.2 (c) (2) (i) of 22 CFR as "education, technical assistance or training programs except to the extent such programs include activities directly affecting the environment (such as construction of facilities, etc.)".

Recommendation

Based on the categorical exclusion discussed above, the Mission recommends that the Trade and Investment Sector Program be given a Categorical Exclusion determination requiring no further environmental review.

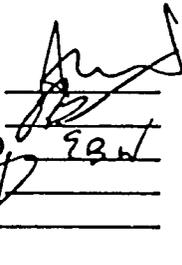
Concurrence:



Terrence J. Brown
Mission Director

2/6/92
Date

Clearances: ANakatsuma, ORD
PNovick, DC/ORD
EWarfield, C/TIO
DBoyd, PDSO
SWingert, DDIR



ANNEX E:
LOGFRAME

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS	
PROGRAM GOAL:	MEASURES OF GOAL ACHIEVEMENT:		ASSUMPTION FOR ACHIEVING GOAL TARGETS:	
To support the achievement of broadly-based, sustainable economic growth in Guatemala within a stable, democratic society	Increase in GDP growth Increase in per capita GDP growth Increase in employment	BOG records & statistics Government records & statistics Management Information System	Continued favorable economic environment Political adoption of changes Policy changes adopted/accepted	
PROJECT PURPOSE:	END OF PROJECT STATUS:		ASSUMPTION FOR ACHIEVING PURPOSE:	
Increase trade and private investment in Guatemala	Increase in the value of NIE from \$420.0 million in 1992 to \$616.0 million in 1997 Increase in trade (exports plus imports) from 52% in 1992 to 54% in 1997 Increase in private investment from 12.8% of GDP in 1992 to 15% in 1997	GOG records & statistics Management Information System MOE's and private sector records Evaluation, monitoring and tracking system T.A. team reports Policy Dialogue Reports	Existence and stability of sound macroeconomic policies Continued willingness of GOG and private sector to collaborate Continued commitment by GOG to increase private sector investment and efforts Private Sector commitment to carry out activities	

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OUTPUTS:	MAGNITUDE OF OUTPUTS:	BOG's records & statistics	ASSUMPTIONS FOR ACHIEVING OUTPUTS:
Open trade regime	Average weighted tariff - reduced from 14% in 1992 to 10% in 1997	BOG's records & statistics Evaluation, monitoring and tracking system	GOG continues its commitment and support to exports and investments Private Sector's confidence in new policies and regulations
Sound investment climate	Tariff rate, increase from 5% - 20% in 1992 to 10% - 20% in 1997	Management Information System Private sector records and statistics	Private banking system, supports, exports and investments
	Increase Direct Foreign Investment from \$114.5 million in 1992 to \$144.5 million in 1997	GOG's records	
	Increase Private Investment as a percent of GDP from 12.8% in 1992 to 15% in 1997		
Deepening of financial markets	Reduce interest rate spread between savings deposits and lending from 8.0% in 1992 to 5.0% in 1997		
	Increase domestic savings as a percent of GDP from 12% in 1992 to 17% in 1997		
Increased production and marketing of non-traditional exports	Increase textile and textile assembly exports from \$113 mil- lion in 1992 to \$165.6 in 1997		
	Increase light manufacturing exports from \$31.3 million in 1992 to \$34.6 in 1997		
	Increase NTAE from \$102 million in 1992 to \$156.0 in 1997		

INPUTS				IMPLEMENTATION TARGET:		ASSUMPTIONS FOR PROVIDING INPUTS:	
AID	OTHER	TOTAL					
(\$000)							
Policy Reform				USAID Project Obligations	No. of person/months working for	All participating institutions con-	
T.A. (15 p/years)	3,000	3,000	USAID Controller's Reports	the project	tinue their commitments to provide		
Public Sector				GOG'S Contribution Records	No. of T.A. (VE's) provided	financial support	
Support				Private Sector contribution reports	BOG/GOG records	GOG counterpart (GC) contributions	
Inst. Streng.	2,250	563	2,813	(CAEM/GREMIAL)	Private sector records	timely provided	
Gremial	(1,750)	(438)	(2,188)			Endowment fund completed	
CAEM	(500)	(125)	(625)				
Business Assiat.							
IESC	1,500	375	1,875				
T&I Promotion	4,250	1,063	5,313				
Gremial	(3,250)	(813)	(4,063)				
CAEM	(1,000)	(250)	(1,250)				
Prog. Management	1,200		1,200				
Eval./Conting.	800		800				

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