Are Tax Breaks the Best Strategy to Make Guatemalan Economy Competitive?

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Are Tax Breaks the Best Strategy to Make Guatemalan Economy Competitive?

by Louisa Reynolds

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"We want to see what we can do to create the conditions to attract foreign investment to Guatemala and prevent what is already happening: investors are choosing other countries such as Haiti, Nicaragua, El Salvador, and Honduras," says Vice Minister for Competitiveness Claudia Del Águila.

The vice minister's words echo the concern expressed in August 2011 by Patricia Figueroa, executive director of El Salvador’s Cámara de Industria Textil, Confección y Zonas Francas (CAMTEX), urging her country's government to pass new laws that would make El Salvador more competitive against its regional neighbors, which were attracting more foreign investment.

Five months earlier, Daniel Facussé, president of the Asociación Hondureña de Maquiladores (AHM), issued a similar warning: "Nicaragua has the lowest wages in Central America, half of Honduras' minimum wage; Honduras’ textile factories have the highest wages in the region. Sixteen textile factories have left Honduras for Nicaragua; the last one left two months ago after the latest increase to the minimum wage."

The notion that foreign capital will flee the country if it does not offer better investment conditions than its neighbors—such as low wages and generous tax breaks—appears to be a common fear among Central American business leaders and politicians. The recent case of South Korean textile factory Sae A. Trading, which decided to leave Guatemala for the new Caracol Industrial Park in northeastern Haiti (NotiCen, Jan. 19, 2012), appears to have heightened these fears.

Built with US$224 million in capital from the US Department of State and the Inter-American Development Bank (IDB), Caracol is a huge export processing zone (EPZ) that will generate 20,000 jobs and put the poorest country in the Western Hemisphere back on the path to economic recovery, say Haitian business representatives.

What they fail to mention is that Sae A Trading, which manufactures garments for Walmart and Gap among other companies and whose profits totaled US$1.1 billion in 2011, left Guatemala amid accusations that it had violated workers’ rights.

The AFL-CIO accuses the garment factory of issuing death threats against workers who tried to form a labor union and even participating in the rape of a female worker. After the long-standing dispute with its workers, Haiti offered Sae A. Trading the opportunity to start from scratch in a country where the minimum daily wage is US$3.75 (this will increase to US$5 in October). Guatemala’s minimum daily wage is US$8.70.

Little concern for workers’ rights

So what does Vice Minister Del Águila mean when she talks about preventing garment factories from fleeing to Haiti? Wage cuts? Turning a blind eye to violations of workers’ rights? "That’s an issue for the Ministerio de Trabajo to deal with," she said when questioned about the Sae A. Trading case.
Economist Ricardo Barrientos of the Instituto Centroamericano de Estudios Fiscales (ICEFI) says cases such as Sae A. Trading are examples of a "spurious model of competitiveness." He added, "Cutting taxes and salaries has been our mediocre strategy to remain competitive. The worst case I've seen is Haiti after the earthquake. What has Haiti done? Garment factories cut wages. What is Guatemala’s and Honduras’ response? We need to cut wages."

A study published by ICEFI showed that incentives such as low wages and tax breaks date back to the 1960s when Central American countries adopted import-substitution policies and they became increasingly popular in the 1990s. In 1989, Guatemala approved the Ley de Zonas Francas, which created export processing zones, as well as the Ley de Fomento y Desarrollo a la Actividad Exportadora y de Maquila, which granted tax breaks to garment factories, both of which still exist.

Carlos Sacalxot, president of the Asociación de Aduanas de Guatemala (AAG), explains that export processing zones or zonas francas were created to attract foreign investment, decentralize industrial activity, generate employment, and fight poverty, goals similar to those set by the business leaders who promote the Caracol Industrial Park in Haiti.

Guatemala currently has 18 EPZs, geographical areas where raw materials are imported tax free and manufactured products are exported. Sacalxot explains that as industrial companies import raw materials and use more labor they receive a more generous tax break (12 years, as opposed to five for the commercial and service sector). "The idea is to reduce unemployment and informal employment, so that the people who are out there selling chewing gum on the streets can find a job in a garment factory," says Sacalxot.

However, of the 226 companies operating in Guatemala’s export processing zones, 209 are commercial (78.5%), 25 belong to the service sector (9.3%), and 32 are industrial (12%), which means that, despite the latter receiving a bigger tax break, they have failed to invest in the country.

The Ministerio de Economía says that, between 2007 and 2012, export processing zones have generated 2,463 jobs, which represent barely 0.1% of the active population. Economist Claudia García, of the Asociación de Investigación y Estudios Sociales (ASIES), says that this number is "barely significant" and adds that "there is little information available on the working conditions offered by these factories, which is extremely important." Added to this, only six EPZs (one-third) are outside the department of Guatemala, which means that industrial activity has not been decentralized.

The Ley de Fomento y Desarrollo a la Actividad Exportadora y de Maquila, which exempts garment factories and others that export at least 51% of their merchandise from paying income and value-added tax for 10 years, initially only included companies that exported goods outside the isthmus "to prevent Central American companies from competing against each other," explains Barrientos. However, in 2004, the law was amended to include companies that export products within the isthmus, which means that today more than half the companies that enjoy these tax breaks are Guatemalan, which defeats the aim of the law, which was to attract foreign investment.

Another contentious issue, says Abelardo Medina of the Superintendencia de Administración Tributaria (SAT), is that, once the 10-year period during which these companies can benefit from tax exemptions comes to an end, many simply close down and reopen under a different name (even if the board of directors and shareholders remain the same) in order to be exempt from taxation for another 10 years.
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