

# CHALLENGES TO EQUITABLE SOCIAL DEVELOPMENT IN GUATEMALA

*A Social Market Economy  
Perspective as a ruling  
concept for a  
better society*



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# **“Challenges to Equitable Social Development in Guatemala A Social Market Economy Perspective as a ruling concept for a better society”**

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## Acronyms<sup>1</sup>

AP	Acuerdos de Paz (Peace Accords)
ASIES	Asociación de Investigación y Estudios Sociales (Association of Research and Social Studies)
BANGUAT	Banco de Guatemala (Bank of Guatemala)
CPR	Political Constitution for the Republic
ENCOVI	Encuesta Nacional de Condiciones de Vida (Living Standards Measurement Survey)
ENIGFAM	Encuesta Nacional de Ingresos y Gastos Familiares (National Survey of Family Income and Expenditures)
EU	European Union
FED	Federal Reserve System
FOB	Free On Board
GDP	Gross Domestic Product
HDI	Human Development Index
IARNA	Instituto de Agricultura, Recursos Naturales y Ambiente (Institute of Agriculture, Natural Resources and Environment)
IDIES	Instituto de Investigaciones Económicas y Sociales (Institute of Economic and Social Research)
IMF	International Monetary Fund
INE	Instituto Nacional de Estadística (National Statistics Institute)
ILAIPP	Iniciativa Latinoamericana de Investigación para las Políticas Públicas (Latin American Initiative for Public Policy Research)
ILO	International Labor Organization
ISR	Impuesto sobre la renta (Income tax)
IVA	Impuesto al valor agregado (Value added tax)
MIDES	Ministerio de Desarrollo Social (Ministry of Social Development)
MINECO	Ministerio de Economía (Ministry of Economy)

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1. Certain acronyms have been kept in Spanish –their original language– to improve the comprehension of other papers and documents that might be of the reader’s interest.

MP	Ministerio Público (Public Ministry)
MINTRAB	Ministerio de Trabajo y Previsión Social (Ministry of Work and Social Precaution)
MSPAS	Ministerio de Salud Pública y Asistencia Social (Ministry of Health and Social Assistance)
SAN	Seguridad Alimentaria y Nutricional (Food and Nutrition Security)
SAT	Superintendencia de Administración Tributaria (Superintendence of Tributary Administration)
SCAE	Sistema de Contabilidad Ambiental y Económica (Environmental and Economic Accounting System)
SEGEPLAN	Secretaria de Planificación y Programación de la Presidencia (Secretariat of Planning and Programming of the Presidency)
SEME	Social and Ecological Market Economy
SESAN	Secretaria de Seguridad Alimentaria y Nutricional (Secretariat for Food and Nutrition Security)
SIGAP	Sistema Guatemalteco de Áreas Protegidas (Guatemalan System of Protected Areas)
SINASAN	Sistema Nacional de Seguridad Alimentaria (National Food Security System)
SME	Social Market Economy
SME-PI	Social Market Economic Performance Index
TFP	Total factor productivity
UNU-WIDER	World Institute for Development Economics Research of the United Nations University
UNICEF	United Nations International Children's Emergency Fund
UNDP	United National Program for Development
URL	Rafael Landívar University
WIID	World Income Inequality Database



# INTRODUCTION

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The main objective of the following study is to assess the feasibility of implementing Social and Ecological Market Economy (SEME) guidelines in the national economy. Furthermore, it aims to be instrumental in analyzing and applying the distinctive principle and elements of this economic model in order to generate a formal policy proposal.

SEME is founded on the understanding that markets are resource allocation and distribution organisms that shape and furnish institutional, ethical, and social conditions needed for efficient and equitable functioning (Resico, M., 2011). The notion of a Market Economy originated with the German economist, Alfred Müller Armack, in his book, "Wirtschaftslenkung und Marktwirtschaft<sup>2</sup>" in 1946 (eumed.net, n.d.).

It was the German Minister of Economy, Ludwig Erhard, who furthered the idea's practical application through the implementation of ordoliberalism and Christian democracy. In the case of Central America, this economic movement has made a number of strides, either in terms of association, international relations, or regional integration (Resico, M., 2011).

This report aims to use the presentation of assumptions and case studies to build an instrumental platform for the evaluation of social, political, and economic conditions, as well as the legislative structure of Guatemala, to help determine the feasibility of implementing this model.

Part I contains a description of Guatemala's social, political, economic, and ecological ambits, all of which are important aspects in the SEME framework. Part II summarizes the philosophical proposal of this model by highlighting its postulates, objectives, and principles, and describes certain constitutional provisions that would allow for the adoption of this model. Part III describes some applications or sectors in which it is important to consider the postulates of this economic model. Part IV presents variable simulations related to this model, and Part V presents the results of a Delphi survey answered by key stakeholders on the

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2. "Directed Economy and Market Economy"

objective of the study, and lastly, provides conclusions and implementation proposals.

This study recognizes the valuable contributions made by a number of institutions and individuals, such as the Rafael Landívar University's Institute of Economic and Social Research (IDIES), specifically Miguel von Hoegen's collaboration in Part II, and Samuel Zapil's collaboration with the economic assessment in Part I, as well as Juventino Gálvez, from the Institute of Agriculture, Natural Resources and Environment Rafael Landívar University's (IARNA), for his collaboration with sections dealing with environmental topics in Parts I and III.

This study was carried out during January to December of 2015. The data used for the parts I and III was compiled from the most recent sources available at the moment, therefore some footnotes were included with the purpose of updating some data.

## **Methodology**

The methodology used is based on an analysis of statistical and documentary information and the use of econometric techniques to simulate variables. Additionally, for qualitative assessment, the Delphi method was used to perform surveys with key stakeholders.



## Part I:

# Economic, social and ecological ambits of Guatemala

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### 1. Sociopolitical aspects

Guatemalan society is characterized by a mix of autochthonous traditional cultures and those introduced by the Europeans. Upon their arrival, the Spanish found a mosaic of ethnic diversity and cultural wealth. The country was conquered in accordance with the ideology of enriching and empowering the Crown, which was interested in domination and resource utilization. Indigenous capitals, such as Q'umarkaj and Iximche were conquered and territorial settlements were set up under a model designed to unify and homogenize regional races. The ethnic and social structure of the colonies was based on a discriminatory and racist system in which perceptions and treatment depended on a person's origin and skin color. New races were created, such as *mestizos*, *mulatos*, and *zambos*, among others. (UNDP, 2005).

In 1821, Guatemala declared its independence, thereby bringing to an end the colonial period which began in 1524. Even so, the *criollo* elite maintained colonial-type power and based the economic system on agricultural production (UNDP, 2005). This era was consecrated by an ultraconservative movement which strengthened the *criollo* nobility and consigned peasants to monocropping. By 1871, the way was opened for the administrations of Miguel García Granados (1871-1873) and Justo Rufino Barrios (1873-1885) and an era of liberalism began.

There was no real change in political processes since power was maintained by autocracies (Maps of World, 2002). The Liberal Revolution was backed mainly by the commercial/coffee growing sectors, the *criollo*, and Ladinos from the Western part of the country. The 1879 Constitution was proclaimed interlaced with the bipolarity that governed and defined the country. On the one hand there was the elite and power concentrations, and on the other was an excluded sector. This period was characterized by a strong *ladinization*<sup>3</sup> process (SEGEPLAN, INE & Univesidad Rafael Landívar, 2005).

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3. *Ladinización* is the word used by Guatemalans to describe the process by which indigenous people abandon their language and culture and adopt those of Western civilization.

The next period that marked deep changes in society was due to the push by equalitarian and democratic bases between 1944 and 1954, starting with the revolution of October 20, 1944, where the Constitution of the Republic of 1945 was raised and enacted; this process was interrupted by the tension transversally found in the traditional differences beyond liberals and conservatives, i.e., rightists and leftists, with Carlos Castillo Armas' intervention by overthrowing Jacobo Arbenz Guzmán, and initiated a period of military dictatorships which culminated in 36 years of internal armed conflict.

Guatemala's recent history established the pillars needed to adopt a State policy of participatory development. This took place during two specific periods:

### **1.1 The shift to democracy (1985-1986)**

At the beginning of the 80's, the Supreme Electoral Court (TSE) and the Citizen's Registry were created with the purpose of generating an electoral census for the upcoming elections to the National Assembly to Reform the Constitution. At that time, 17 political parties and 4 civic committees made an appearance, but there was a marked absence of left-wing parties, due to the ongoing armed conflict. Since this was an effort to return to a democratic government once the authoritarian era was over, the current Political Constitution of the Republic was enacted and several institutions were created, such as the Ombudsman's Office, the Constitutional Court, and the General Comptroller's Office<sup>4</sup> and new government dynamics were forged, such as the municipal regime and the urban and rural development councils, the decentralization and the administrative autonomy.

There are theories that affirm that democracy was an elitist construct which was imposed and not consensual. Villamizar (2009) claims that it may have been a process led by the private sector *vis-à-vis* instability affecting their operations. He also maintains, based on Rouquie's experience, that foreign governments viewed democracy as "an alternative and an instrument to reduce the efficacy of revolutionary processes". (Villamizar, 2009)

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4. Comptroller's Office was created in the constitution of 1945, but was also established in the constitution of 1985.

## 1.2 The signing of the Peace Accords (1991-1996)

The signing of the Peace Accords (AP) bolstered the democratization process in Guatemala, brought an end to the armed conflict, and established a comprehensive agenda geared towards laying the groundwork for socio-economic and political development. One of the most important points deals with recognizing different ethnic groups of the Maya, Garifuna, and Xinca people; therefore, the recognition of cultural rights was encouraged, such as language, toponymy, spirituality, sacred places, and other customs (Acuerdo sobre identidad y derechos de los pueblos indígenas, 1995).

With regard to the theory that democratization was imposed and that the Peace Accords were determined and led by certain groups, Garreton (2001) feels that, in Latin America, "negotiations and agreements reached at the level of power groups and the elite tend to replace social movements during democratic transition and consolidation processes". According to studies on political culture and democracy in Guatemala, eight of every ten Guatemalans feel that the Peace Accords were good or very good for the country (Azpuru, D., 2012).

Batres & Castro (2012) mention that certain political groups did not participate or have political representation. An added complication is that multi-cultural contexts can heighten differences and political parties may arise in connection with certain ethnic groups. Table 1 illustrates how the representation of indigenous people in Congress is not in proportion<sup>5</sup> to their relevance in terms of size of population (Batres, S., & Castro, J., 2012).

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5. According to the National Statistics Institute, over 40% of the population in Guatemala is indigenous.



**TABLE No. 1.**  
**Number of indigenous congress people in the Guatemalan Congress**

<i>Term</i>	<i>Total congress people</i>	<i>Indigenous congress people</i>
1986-1991	100	8
1991-1996	116	6
1996-2000	80	9
2000-2004	113	15
2004-2008	158	15
2008-2012	158	17
2012-2016	158	22

*Source: Batres & Castro based on Cojti and TSE information.*

Lastly, with regard to democratic governance, it is good to see that local governments have mid to high levels of citizen trust. Public institutions, such as Congress, the Executive, and political parties do not score so high (according to bi-annual studies on the political culture of Guatemalan democracy) (Azpuru, D. & Zechmeister, E., 2015). This finding suggests that the closer politics is to the needs of the citizens, the more effectively government can act and the more difficult it becomes for non-transparent practices to prevail.

### **1.3 Social democratization**

The needs of the population as identified in the AP have not been fully satisfied. In socio-economic aspects, wealth is still highly concentrated and poverty continues to affect over half the population. There is a fiscal policy designed to reduce income gaps; however, the tax system is regressive. Various social programs have been prioritized in terms of funding, but are still insufficient. In this regard, the past few administrations have implemented social programs focusing on conditional cash transfers.

Alfonso Portillo's administration (2000-2004) carried out actions designed to promote social reform, focusing on education, health, and labor aspects. With regard to the latter, minimum wage was increased to help employees recover purchasing power; however, this led to the displeasure of the business sector (Departamento de Investigaciones Sociopolíticas, 2003), (SEGEPLAN, 2006).

In other respects, Portillo's administration reformed the Law on Urban and Rural Development Councils. Adopted in 1987 and reformed in 2002, this law provides for a structure to promote local participation, generate greater knowledge of issues facing the population, and enhance the legitimacy of government policies. However, this system has not been as effective as possible and has lent itself to cronyism (Gereda, M., 2011). Budget priorities established through the Councils' bottom-up participatory planning system are commonly overridden by negotiations between the executive and legislative branches during the national budget approval process. Combined with corruption in municipal government, this practice leads to the development of patronage relations between municipal leaders, members of congress and governors, which undermine the system's effectiveness.

Oscar Berger's administration (2004-2008) implemented the *Vamos Guatemala* program which was based on four strategies (i.e. *Guate Crece*, *Guate Solidaria*, *Guate Compite* and *Guate Verde*). The one called *Guate Solidaria*, sought to "create social harmony through the generation of assets, enabling families to access human development opportunities that will guarantee them a better future" (SEGEPLAN, 2006).

Alvaro Colom's (2008-2012)<sup>6</sup> government plan focused on promoting social programs<sup>7</sup> to reduce poverty and empower women (i.e. *Mi Familia Progres*, *Bolsa Solidaria*, *Comedores Solidarios*), improving opportunities for children and youth (i.e. *Escuelas Abiertas*), and others geared towards comprehensive and unifying policies.

In the social arena, Otto Perez Molina's administration (2012-2015)<sup>8</sup> drafted and implemented the Zero Hunger Pact to ratify commitments and outline a strategy to improve maternal/infant health and nutrition. With regard to institutional aspects, the Ministry of Social Development (MINDES) was created to continue with the social programs established during the previous administration.

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6. This government adopted the recent term "Social Cohesion" which was made popular by the XVII Latin American Summit for Social Cohesion, which coincided with Alvaro Colom's taking office.

7. These policies are based on international experiences from Brazil, Chile, Mexico, and Argentina (President's Office, 2011).

8. After being accused of corruption, the President resigned on September 2, 2015. On September 3, Alejandro Maldonado Aguirre was sworn in.

## 1.4 Corrent social scenario

According to the Living Standard Measurement Survey (ENCOVI) performed by the National Statistics Institute (INE) in 2011<sup>9</sup>, general poverty is at 53.71% and extreme poverty reaches 13.33%. The most affected regions are Alta Verapaz (in the North) and several provinces in the Eastern part of the country. According to the United Nations Development Program (UNDP), on the Human Development Index (HDI) Guatemala ranks mid-range, with a score of 0.628, identical to Kyrgyzstan in Central Asia and very close to Namibia in Africa (0.624) (UNDP, Informe de Desarrollo Humano, 2013).

Over half the population lives in adverse conditions and this impacts other areas of human development. This is evidenced by other social indicators, for example: chronic malnutrition indicators<sup>10</sup> rank the country quite unfavorably in comparison with the rest of the world, as 49.8% of all children under the age of five suffer from this scourge (ENSMI, 2008) (MSPAS, INE & Centros de Control y Previsión de Enfermedades (CDC), 2010).

The issue of chronic malnutrition should be highlighted since it is rooted in access (economic and physical), availability (this aspects takes on greater relevance in light of the effects of climate change), consumption, and use biological utilization of food. According to UNICEF's malnutrition glossary, chronic malnutrition is "stunting, as measured in height to age (H/A), usually associated with poverty, resulting in learning difficulties and lower economic performance" (UNICEF, n.d.).

Although food and nutrition insecurity is a topic that has become more and more popular among social actors, especially in the area of public policies, efforts in this regard must be further strengthened. During the past ten years, significant progress has been made, particularly in the area of institutional frameworks; today, there is an Executive Secretariat for Food and Nutrition Security (SESAN) as described in the Law for a National Food and Nutrition Security System (SINASAN) (Decree 32-2005), which reads:

The Secretariat is the coordinating body for SINASAN and is tasked with coordinating operations between ministries for the SAN

9. On December of 2015, INE published the results of the ENCOVI 2014, in which the general poverty did increase to 59.3%, extreme poverty reached 23.4%;Alta Verapaz persisted as the most affected department of the country.

10. The percentage of children under the age of five with malnutrition is 46.5% according to the ENSMI 2014-2015.

Strategic Plan, as well as articulating various programs and projects from different national and international institutions linked to food and nutrition security in the country. (Congreso de la República, 2005)

Poverty is most prevalent in rural areas where State institutions are not present and the population is primarily indigenous. The UNDP indicates that, “81% of the indigenous population lives in municipalities which are not departmental capitals and in which State presence is limited (INDH 2009/2010)” (UNDP, 2014).

This situation has motivated public policy-makers to include elements that will attract social capital, such as the so-called “social programs” focusing on poverty reduction, which have been implemented for roughly the past ten years. Recently, “social program” is the moniker assigned to programs linked to conditional cash transfers that, in theory, respond to an approach in which technical poverty and nutrition criteria prevail.

However, it is important to mention that there is not enough information to evaluate the impact and success of said programs. In spite of this fact, in recent years, the State has continued to invest public resources in this type of program instead of assessing whether it would be wisest to refocus certain actions for better results. One specific recommendation in this regard was made during the Latin American Initiative for Public Policy Research (ILAIPP, 2014):

In order for these social policies and programs to meet their objective, they must be implemented under a legal and institutional framework; in other words, they cannot be implemented through quasi-formal government structures, since opacity, improvisation, and the unacceptable practice of cronyism would prevail in the implementation mechanisms. (ILAIPP, 2014)

The subject of poverty and its consequences is still in the spotlight. Recently, both national and international actors have been focusing on a social phenomenon closely linked to poverty: migration. During the past few years, a great number of Guatemalans have immigrated to other countries, especially the United States, in light of the lack of opportunities and development in their own country, and this has of course had significant repercussions.

In this regard, Azpuru & Hernández (2015) indicate that “there is a correlation between the desire to migrate and a negative perception of

the family's economic situation" (Azpuru D. & Hernández, V., 2015). Evidence suggests a need to implement actions to improve living conditions for Guatemalan families. In pursuit of this objective and *vis-à-vis* the underscored humanitarian crisis of unaccompanied minors from Central America immigrating to the United States, the countries in the so-called "Northern Triangle" (Guatemala, El Salvador, and Honduras) proposed an "Alliance Plan for the Prosperity of the Northern Triangle", whose strategic actions are linked to energizing the productive sector, developing human capital opportunities, enhancing citizen security and access to justice, and building the State's institutional capacities. This plan, which aims to reduce poverty and thereby prevent immigration to the United States, will receive up to 750 million U.S. dollars in funding from said nation (Ministerio de Relaciones Exteriores, 2016).

In the case of Guatemala, if the State is to step up its participation in social services, such as health, education, and security, a comprehensive fiscal reform is absolutely essential in order to secure sufficient resources and ensure quality and transparency in their execution. The last tax reform was approved in 2012 and was anxiously awaited, since it focused on income tax (ISR), which is one of the biggest generators of revenue in terms of direct taxes<sup>11</sup>. As part of the Peace Accords (1996), the established tax burden should represent the equivalent of 13.2% GDP by the year 2000. Since this goal was not reached, it was included in the 2002 Fiscal Pact and remains a pending task to this day.

When looking at Guatemala's social democratization efforts, political rhetoric increasingly acknowledges the problem of inequitable social development, but the political implementation still lags behind most people's expectations. A substantial problem is that while Guatemala has made great progress in realizing the need for building a society in which people have more equitable access to social services and economic opportunities, the country is not yet sufficiently prepared to generate the necessary fiscal resources to support the needed public investments into social mobility for viable employment and productivity through productive infrastructure and macroeconomic stability. Moreover, it is not yet politically capable of allocating these resources to subnational governments, which have much higher political support ratings by citizens than the central government.

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11 In 2014 the direct taxes represented 36.84% (indirect taxes 63.16%) of the fiscal revenue, which shows a regressive system of taxation.

## 2. Economic assessment

The economic situation in Guatemala has undergone drastic changes from its beginnings in ancient Mayan Civilization, where it was based on agriculture and a network of commercial routes. By 1524, the colony's economic system was still founded on agriculture because of the scarcity of precious metals and other minerals. At the beginning of the Colonial period, the monetary system was practically non-existent and relied on currency minted abroad; therefore, bartering or the use of unminted metal was common in commercial transactions. The Guatemala Currency House was established in 1773 and, from that date on, Guatemala minted its own silver currency<sup>12</sup>. Tribute was paid to the Royal Treasury, thereby setting the precedent for modern tax collection structures.

Prior to 1821, the year independence was declared, low tax revenue resulted in an economic crisis. Commercial freedom was granted, but resulted in increased imports, combined with decreased indigo exports. *Criollo* and conservative powers were established and reigned until the Liberal Reform of 1871, and were characterized by monocropping and an increased reliance on foreign investments (Luján Muñoz, J., 2012). Dictatorial governments were imposed to the benefit of foreign agricultural companies, mainly coffee and banana growers who heavily influenced national decision-making. Budget and tax reforms were made in response to the drop in salaries resulting from the Great Depression. A monetary reform adopting the gold standard was implemented and the Central Bank was established as the issuer.

During the revolutionary process (1944), international coffee prices favored production and availability of foreign currency. Farmers began to diversify export crops, such as cotton and citronella, and began producing sugar and livestock. The Industrial Development Law provided further benefits to workers and, in part, contributed to economic and social improvements, although the political situation remained unstable (Luján Muñoz, J., 2012).

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12 The Main Currency Houses of the Spanish Crown in America, located in Mexico, Bolivia and Peru, as well as the Spanish Currency House coined the early Guatemalan currency, which circulated until the first three decades of the nineteenth century (Banco de Guatemala, n.d.).

## **2.1 The reconstruction and reinsertion of the national economy**

Starting in 1954, producers began to diversify and modernize agricultural export products (cotton, meat, sugar, cardamom, and others). In order to develop industry, several Latin American countries, including Central America, adopted an import substitution model. In this regard, it is important to point out that the State was promoting industry through “bank credit, import tax exemptions for certain goods and tax amnesty for new local industries” (UNDP, 2010).

During this time, State support translated into improvements in the economic field; however, there were no substantial social improvements for agricultural and industrial workers. Torres Rivas states that while the State was busy promoting agricultural and industrial development, it was also weakening itself, especially with regard to fiscal matters (Torres-Rivas, E, 2010), (UNDP, 2010).

Later, starting with the democratic era (1986), the State adopted the Washington Consensus recommendations. According to Sosa (2010), these measures allowed the economic scenario of the 80’s (high fiscal deficit, strong inflationary pressures, multiple exchange rates, among others) to be overcome, but he also recognizes that this did not generate the desired social effects. If the Consensus recommendation had been fully implemented, the implications for society, together with a good economic policy, would have been very positive, but as it is, there was only partial implementation lacking political will. However, continuing with the irresponsible macro-economic policies of earlier years would have been disastrous (Sosa, 2010).

Guatemala is one of the poorest countries in Central America. Access to basic services, dignified job opportunities, good diet and nutrition, combined with inequitable resource distribution, excludes a large part of the population, resulting in protests and social movements to demand social and economic change. Recently, corruption and impunity has exacerbated social unrest. Additionally, drug trafficking, organized crime and money laundering have brought about a number of other issues that have impacted development in recent years.

With regard to achieving economic consolidation, it is interesting that the Global Competitiveness Report (2014-2015) highlights the fact that countries undergo a number of different development periods, and ranks Guatemala in a period of efficiency. According to González (2005), starting



in the 80's, Guatemala, as well as many other countries, shifted from an agricultural-based economy to a more industrial and services oriented one. Consequentially, Guatemala has been promoting laws designed to boost exports, particularly in the garment industry.

Despite the global financial crisis of 2008, Guatemala was not severely affected; according to BANGUAT (2015), between 2001 and 2014 the GDP grew 3.5%. During the crisis, in 2008, the country reported the lowest growth rate: 0.5 percent. Notwithstanding, in 2007, this indicator was at 6.3 percent, the highest rate of the past fourteen years.

In 2013 and 2014, economic growth maintained an upward trend, reporting moderate growth rates of 3.7% and 4.2%, respectively. Public spending grew by Q.20,463.3 million (50.7%) between 2008 and 2014, due to an anti-cyclical program implemented to counteract the global economic crisis. For this same reason, total revenue dropped 4.3% in 2009, primarily because there was less tax revenue, as a result of a 12.7% drop in import IVA and 6.2% drop in global IVA (domestic and import), as well as an 11.9% drop in import duties in comparison with 2008. Nevertheless, the year's tax collection goal was surpassed by Q.1,130.5 million, over 3.5% regarding the Q. 32,619.4 million tax goal of 2009, established in the agreement of the Superintendence of Tributary Administration (SAT) and Executive Organism (Superintendencia de Administración Tributaria, 2009)

In the years after the crisis, tax revenue maintained steady growth, although less than expected. In 2014, tax revenue reached Q. 49,096.9 million, somewhat under the expected amount of Q. 51,500.7 million. This was because income tax collection was Q.2,448.5 million less than the projected amount in spite of showing the highest absolute growth of any tax in 2014, by bringing in Q.1,431.5 million as a result of tax reforms approved in February 2012.

Broadening this analysis, it is important to note that over the last fourteen years, the Industrial sector has been the largest contributor to national GDP; up to 24.8%, according to BANGUAT (2015). Another significant contributor is the agricultural and mining sector, which has contributed 14.4% to the GDP. Nonetheless, the services sector (transport, storage and communications; financial services, insurance brokerage and ancillary activities; private services and public administration and defense) represents about 40% of the GDP and appears to have been gaining strength during the past fourteen years.



## 2.2 Inflation<sup>13</sup> in Guatemala

Another important aspect to consider is the evolution of inflation. According to BANGUAT (2015) data, there have been a number of up and downs; for example during 80's, inflation could be categorized as hyperinflation with rates reaching 27.9% in 1985, 21.5% in 1986, and 20% in 1989. However, the highest inflation rate was in 1990, when it climbed to 59.8%.

After 1990, Guatemala strengthened its inflation management capacities and inflation dropped to an average of 11.1% between 1991 and 1996. Over the next twelve years, inflation did not surpass the 10% limit, but settled at an average of 7.3%.

In 2009, there was 0.28% deflation, not the first time this had happened, but the most recent one. After this particular event, inflation reached a maximum of 6.2% in 2011 and began dropping until it reached 2.95 in 2014.

## 2.3 National budget and deficit

Looking at the deficit, data gathered from 1980 to date shows three important features: 1) as of 1983 Guatemala correctly handled its deficit (as a GDP percentage) and kept the average below 4%; 2) in 1980, 1981, and 1982, the deficit was over 4%; and 3) Guatemala's highest deficit was in 1981, at 7.4%.

Furthermore, over the past twenty years, the budget has been funded almost entirely through taxes, 92.3% on average. During this same period (1994-2014), tax revenue represented 10.9 % of the GDP on average, while public expenditure was at 13.5% of the GDP (MINFIN, 2015).

Between 1995 and 2014, indirect taxes made up 73% of the revenue and direct taxes made up 27%. The percentage of indirect taxes has been dropping over time; in 1995 it was 79%, whereas in 2015, it had dropped to nearly 64% (MINFIN, 2015). Nevertheless, this percentage is still high if the aim is to achieve a progressive tax system.

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13 In 2002, BANGUAT adopted an inflation target program based on the premise that low, steady inflation has a positive impact on economic development (Lopez 2015); in the case of Guatemala the target is 4 percent +/- 1p.p. (BANGUAT, 2015)

The counter-cyclical policy adopted in response to the 2008 economic crisis caused a jump in the fiscal deficit as percentage of the GDP, doubling what it was in the years before the crisis. In absolute terms, the deficit has stayed above Q.8 billion, although still within acceptable IMF parameters, and is not greater than 3.3% of the GDP for the aforementioned years; the IMF would call this a moderately counter-cyclical policy. The State has repeatedly borrowed from international financing agencies to fund the fiscal deficit, in addition to placing treasury bonds on local and European markets. This has led to a 55.9% increase in public debt in only six years, bringing it to Q.111,422.4 million in 2014, with a GDP weight of 24.2%.

## 2.4 Macroeconomic stability Indicators

Finally, after a brief analysis of the macroeconomic scope, it is essential to take a look at the next macroeconomic stability indicators.

**Table 2. Guatemala: macroeconomic stability indicators; years 2001, 2005, 2010, 2013 and 2014**

	Standard	Year				
		2001	2005	2010	2013	2014
Deficit /GDP***	3%	2.1	1.7	3.3	2.1	1.9
Inflation**	5%	8.9	8.6	5.4	4.4	2.95
Public debt*/PIB ***	60%	21.5	21.0	24.5	24.9	24.7
Central government debt /						
Tax revenue ****	250%	162.7	172.7	214.5	212.40	224.90
Central government debt services						
Tax revenue***	30%	12.12	17.5	18.7	18.80	21.46

Source: Minister Finance (2015) (last review December 02, 2015); Banguat (last review December 02, 2015)

\* Represents Government debt plus debts granted to decentralized and autonomous institutions and Banguat's debts (until 2004)

\*\* Target inflation policy (Banguat)

\*\*\* The Maastricht Treaty (EU)

\*\*\*\* World Bank and IMF

According to Table 2, Guatemala's macroeconomic stability indicators are performing well: low deficit, below 3% of the GDP over the last fourteen years (with the exception of 2010); inflation has been decreasing over the same period of time, dropping from 8.9% in 2001 to 2.95% in 2014.

With regard to foreign trade, in 2009, FOB values for exports were at US\$ 7,294.9 million, US\$ 551.6 million (7.0%) less than the amount reported in 2008. One factor had to do with the US\$ 525.4 million drop in general merchandise exports to Central America and the rest of the world, mainly the United States, due to the global financial crisis of 2008. In 2009 and 2010, exports grew again by 17.3% and 22.9% respectively, thanks to higher prices for raw materials. However, this was not the case in 2012, when exports represented US\$ 10,106.8 million, or 3.9% less than the previous year. This was due to a US\$ 415.7 million (-4.0%) drop in general merchandise exports, resulting from drops in commodities (-4.1%) and other products (-4.0%), the determining factor being lower prices for raw materials on the global market. This closed out the period of high prices reported during the post-crisis years (BANGUAT, 2009) (BANGUAT, 2014).

In 2014, exports grew by 7.6%; although there was a drop in international commodity prices, this was compensated for by greater volumes. The most dynamic exports were: metallic minerals, iron and steel products, natural rubber, crude oil and gas, pickled vegetables, and non-alcoholic beverages.

In turn, in 2009, imports experienced a severe decline, reporting a value of only US\$ 10,643.1 million, US\$ 2,778.1 million (20.7%) less than the amount reported in 2008. This behavior is linked to reduced economic activity in the country during that year, which led to a lower demand for imported products, particularly raw materials and intermediary products for national production. General merchandise exports came to US\$ 10,641.5 million, a 20.7% drop in comparison with 2008. Goods transported from foreign ports dropped 38.5%, from US\$ 2.6 million in 2008 to US\$ 1.6 million in 2009 (BANGUAT, 2009).

In 2012, import value increased slightly from US\$16,614 million to US\$ 16,994 million, a 2.3% increase over 2011. This is explained in part by slower growth in imports of manufactured goods and mineral products, which decreased from 8.2% in 2011 to 3.4% in 2012.

In 2014, imports increased by 6.0%, up from 4.3% in 2013, because of increased volumes of consumer goods, fuel and lubricants, raw materials and intermediary materials, and capital goods, primarily those related to agricultural and transportation machinery and equipment.

After the global financial crisis, the country's monetary policy played out in an international arena hard hit by economic recession and within an

internal context which was strong in macro-economic terms, in spite of the effects of decreased imports and weakened exports. Also, the deceleration observed during rising inflation cleared the way for a flexible monetary policy which complemented a moderately counter-cyclical fiscal policy backed up by greater debts linked to lower tax revenue.

At the beginning of 2009, the lead interest rate was at 5% and slowly dropped to 4.5% at the year's end. The monetary authority's decisions in this respect attempted to send signals to economic agents to monitor inflation rates and therefore, modifications to the lead interest rate take into account the behavior and expectations of this variable.

Lastly, the recent evolution of the national banking system undergone during 2014 is proof of its solvency, as measured by solvency, liquidity, credit, and profitability indicators, as well as average scores on positive legal reserves of both national and foreign currency. Credit risk as measured by the quality of the loan portfolio held steady at record lows, surpassing longtime levels of 5%. Contaminated portfolio coverage continued to exceed 150% and profitability indicators were similar to those of the previous year. All this is proof of the consolidation of progress in terms of banking system efficiency (BANGUAT, Estudio de la Economía Nacional, 2014).

From a macroeconomic perspective, it can be concluded that while Guatemala can look back at a highly turbulent history and great vulnerabilities to exogenous shocks, it has made substantial progress in terms of sound macroeconomic policies. The country's greater catch-up needs are in microeconomic areas like improving the country's regulatory framework and governance to strengthen competition and to broaden access to economic opportunities.

### **3. The environment and natural resources**

In Guatemala, the environment, natural resources, and the concept of nature in general is based on the Maya world vision which integrates an entire value system covering man and his connectivity to his surroundings (UNDP, 2006). The concept of a natural environment refers to a set of "goods or resources" as well as "conditions" that make life possible. The ecosystem and diversity must be accompanied by protection and sustainability.

Human actions, particularly those related to productive processes, together with the ever growing power of globalization and the expansion of commercial processes abroad, have put Guatemala and the rest of the world in local environmental debt. Industry generation has not exactly been accompanied by timely efforts to prevent and minimize environmental crises by reducing greenhouse gas emissions. Climate change is an undeniable problem the world over and considerable investment is needed to deal with its consequences through the creation of an inclusive development model.

Increasing temperatures around the world, environmental conflicts, and the country's cumulative vulnerability all contribute to the occurrence of natural disasters. During the past 20 years, Guatemala has experienced a number of crises exacerbated by human actions, such as hurricane Mitch (1998), tropical storm Stan (2006), and tropical storm Agatha (2010) which struck the country precisely when a major volcano was erupting. Human actions, such as deforestation, excessive demographic expansion, and improper waste handling, among others, all aggravate natural disasters.

"Conservation biology" is based on functional and ethical-normative postulates. It is important to recognize that species are interdependent and that essential ecological processes fail when the systems that support them are too small. Ethical-normative postulates are the diversity of organisms, ecological complexity, and evolution, as well as biological diversity, which has intrinsic value regardless of its utilitarian value.

### 3.1 Guatemala and its relationship with the environment

Guatemalan economy is well grounded in agriculture and nature. In the context of environmental economy, nature is viewed as a public asset. Environmental economy grants two characteristics<sup>14</sup>. The first is non-exclusion, in the sense that it is impossible to prevent everyone from either benefitting or suffering as a result of the state of the environment, and the second is non-rivalry in enjoyment of the asset. In other words, the fact that one person enjoys it does not prevent another from doing so.

From the perspective of political ecology, the “state” of nature in any given place or time depends a great deal on, primarily, economic and socio-cultural dynamics, some of which are incentivized by public policies and other which are entirely beyond their control.

Guatemalan environmental laws arose out of a need to protect system conditions, rather than out of a country initiative to promote a clean economy and conditions to integrate mankind’s activities with different ecosystems. The Law for the Protection and Improvement of the Environment deals with preventing pollution and is founded on article 97 of the Constitution, as well as on different approved and ratified international agreements.

In 1989, the Guatemalan System of Protected Areas (SIGAP), which covers approximately 32% of the country, was created in order to protect the country’s biodiversity.

### 3.2 Issues with using environmental resources

From a systemic perspective, and specifically in the analytical framework of a socio-ecological system, the country’s environmental problems are no more than symptomatic expressions of historical-structural relationships established in a natural environment and economic, socio-cultural, and political-institutional dimensions, as well as the relations between this national socio-ecological system and the rest of the world. (Torres-Rivas, E, 2010).

With regard to the economy, it is evident that the rules of production and consumption determine the type and intensity of its impact on the environment. In Guatemala, there is a double relationship between the

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<sup>14</sup> Not all components of nature fulfill these characteristics, and are therefore called contaminated public assets.

economy and the environment. On one hand, various economic activities extract goods and resources from nature, and on the other they are returned as waste. The magnitude and dimension of problems and crises is essentially due to the degrading and polluting nature of said activities in production, distribution, and consumption phases, as well as to shirking any efforts to mitigate their effects.

In socio-cultural dimensions, social fragmentation and the resulting lack of social agreement with regard to the strategic value of the environment in the continual search for wellbeing is a driving force in environmental degradation. Consequentially, fragmented groups caring only for their own interests or particular cultural standards set different values on the various components of nature, and land becomes a virtual battle field. Of course, disputes always favor the sectors with the greatest economic and political power. While these battles are being waged, the courses of exhaustion, degradation, and pollution remain steady, growing, and perfectly correlated to disorderly and excluded population growth.

In institutional dimensions, the cause that determines the state and evolution of environmental crises is weakness caused by financial exclusion, among other reasons (annual investment in environmental matters during the past ten years has not exceeded 0.5% of the GDP); this is expressed in insufficiency, absence, or harmful presence. This institutional condition can be understood as the result of its instrumentalization, conceived and materialized under the first of the aforementioned dimensions (economic) and whose viscous cycle cannot be broken because of a lack of social checks, which are unfeasible or insufficient as a result of the second dimension (socio-cultural).

Guatemala's environmental debt goes hand-in-hand with productive processes and the fact that climate change has generated the necessary conditions for a socio-environmental crisis (IARNA, 2009).

### **3.3 Main consequences of society's activities**

or more than ten years now, in several eco-regions<sup>15</sup> in the country there has been an accelerated loss of forest coverage to provide land for agricultural and urban uses. In 2003, forest coverage was at 4.2 million

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15 These are relatively large extensions of land containing different arrangements of natural communities and species, with borders comparable to original ones prior to changes induced by human intervention (IARNA-URL & BANGUAT, 2011).



hectares, or 38.6% of the territory. Almost 60% of the land is used for two main purposes: 1) agricultural crops (27.5%) and 2) natural pasture and grasslands, scrubland and brush<sup>16</sup> (31%). Land use distribution in the different eco-regions was irregular in the reference year, but it is interesting that over 30% of the territory is used for annual or perennial crops in seven of the 14 eco-regions.

To date, the rate of deforestation has increased and natural forests have been systematically reduced to make way for annual or permanent crops and urban centers. The Environmental and Economic Accounting System (SCAE) shows the evolution of forestry activities from 1950 to 2010. In 1950 there were almost seven million hectares of forest (64.5% of the territory), but by 2010, it was reduced to 3.7 million hectares (34.2% of the territory), which represents a 47% decrease in coverage over 60 years.

From 2001-2006, gross deforestation rate was a little over 100,000 hectares, whereas from 2006-2010, this figure reached a little over 132,000 hectares annually, of primarily natural forest, affecting the already decimated tracts of forestlands, particularly in the *Franja Transversal* and Peten regions in the Northern part of the country and even reaching legally protected areas<sup>17</sup>.

Deforestation rises out a need for space or resources and various direct pressures, including drug trafficking (and land occupation as a result of internal migration of rural communities who view protected areas as their only option). Similarly, other sources of deforestation include forest fires, urbanization, pests and diseases, monocropping, livestock, illegal logging, and combinations of these factors. Steady loss directly impacts the conservation (or degradation) of the different eco-regions and the country as a whole.

SCAE shows that the country's economic activity is accompanied by demands for various environmental components. The flow of said components is inherent in socio-natural relations and inevitably generates negative impacts on the environment. The most noteworthy environmental flows towards economy are those related to water, energy-producing materials, and lumber. In general terms, these flows showed an upward trend from 2001-2010.

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16 Land left fallow for a time and later used for agricultural purposes.

17 At least 37% of the gross national deforestation occurs within protected areas.



### 3.4 Main effects of economic activities on the environment natural

There are main flows from economy back to the environment: (i) water return, (ii) gas emissions, and (iii) solid waste generated in production and consumption processes (INE, BANGUAT & IARNA-URL, 2013).

Part of the water is used for different economic activities and incorporated into a variety of products, whereas another part is returned to the environment after undergoing significant modifications which limit its use for other processes and contributes to the pollution of both water and soil. Although there are yearly fluctuations linked to the dynamics and relevance of the different economic activities, in general terms, the volume of returned water steadily increased from 2001 to 2010.

Studies show that the most significant economic activities in terms of water return are: coffee milling, agricultural activities, and manufacturing industries, which represent 37%, 15%, and 7% respectively of the 15,536 million m<sup>3</sup> of water returned in 2010. During this same year, energy generation and distribution represented 33% of the return<sup>18</sup>. In turn, household contributed 2% of the water return, and other economic activities were responsible for the remaining 8%.

Greenhouse gas emissions showed an upward trend during the 2001-2010 period, with the exception of the values reported for 2007-2008, where there was a slight decrease. Emissions increased by 23%, from 41.2 to 50.6 million tons of CO<sub>2</sub>-equivalent emissions between 2001 and 2010. Ninety percent of the CO<sub>2</sub>-equivalent emissions reported in 2010 were associated with CO<sub>2</sub>, whereas 9% and 1% were CH<sub>4</sub> and NO<sub>2</sub> respectively. In sector-wise terms, homes (final consumers) were responsible for 60% of the emissions generated in 2010, primarily through burning firewood. Electricity generated 14% of the emissions, the manufacture of other non-metallic mineral products (cement, lime, and calcium sulfate) produced 5%, baking and milling processes produced 4%, and transportation produced 3% of the emissions generated in 2010. The remaining 10% is attributable to other economic activities.

SCAE shows that the smallest amount of solid waste was produced in 2001, at 81.9 million tons, whereas 121.7 million tons were produced in 2007, which was the maximum for this period. Most of the solid waste

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<sup>18</sup> Hydroelectricity does not imply significant changes to the water used.

generated in 2010 was produced by manufacturing industries. Of the almost 113 million tons generated by the economy in that year, 90.1 million, or 80%, was produced by said industries. Agricultural activities were responsible for 17%, and households produced 1% of the total amount generated in 2010 (IARNA-URL, 2015).

From an ecological perspective, Guatemala is a vulnerable country which relies considerably on the extraction of renewable resources. Guatemala extracts these resources at a rate much faster than the country replenishes them. At the same time, the country's national accounting system considers the sales of its natural resources as value added to its national income, but it does not have a meaningful concept to account for the loss of its natural resources and biodiversity as a factor of capital depreciation. Because this is a problem that many countries face, the World Bank has started to calculate a country's adjusted net national income, which is gross national income minus consumption of fixed capital and natural resources depletion. The World Bank's measure of adjustable gross national income is therefore a measure that can be interpreted as ecologically sustainable income. Then, looking at the actual data shows that Guatemala's official annual gross national income between 1970 and 2013 is on average eight percent higher than its adjusted one. In other words, over the last 44 years, Guatemala has, on average, derived every year around eight percent of its income from ecologically non-sustainable resources (World Bank, Online).



## Part II:

# **SME Postulates/operative principles**

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### **1. Social Market Economy objectives and operative principles**

The idea of the Social Market Economy evolved in Germany after World War I. Its objective is to order the political and economic system such that the freedom in the market serves equitable socioeconomic development. The SME objectives and the operative principles through which they are implemented are based on two ideological sources (von Hoegen, M, 2015):

- 1) Ordoliberalism (Hasse, Rolf H., 2008) which is the combination of a) the classic school of economic thought or liberalism and b) the acceptance of a strong governmental intervention in order to guarantee rule of law: economic and social legal norms are observed and implemented.
- 2) Christian thought, in order to cope with social and economic difficulties.

#### **1.1 Origin, Aims and Scope of Social Market Economic Thought**

Although originally designed as a model for post-World War II Germany, the concept of the Social Market Economy is neither a German model, nor a German theory. Rather, it is an intellectual movement that simply originated in Germany and which gained considerable influence over German politics after World War II. Yet, just like Anglo-Saxon economics draws on ancient Greek political philosophy, medieval scholastics, and French Physiocracy, so is the Social Market Economy a synthesis of many intellectual contributions from around the world. Because Social Market Economic thought is a recent branch of intellectual economic doctrines, it can be interpreted as a sieve of the history of economic thought and

economic history itself. This sieve tries to isolate those historical lessons and economic policy principles that have proved conducive to realizing the objective of a Social Market Economy: The combination of market freedom with equitable social development.

## **1.2 The Idea Regarding the Nature of the Human Being**

The concept of the Social Market Economy is often compared to laissez-faire liberalism and socialism. The idea regarding the nature of the human being in laissez-faire liberalism and socialism is defined by nothing but self-interest and pure solidarity, respectively. The pursuit of self-interest in laissez-faire liberalism calls then for a night-watchman State, in which the government's role is limited to protecting the individual's property rights of private production factors. In a utopian socialist world, citizens allegedly do not even want private ownership of means of production and all individuals are glad to subordinate themselves to a central planner State which drafts the plans for the production of goods and services as well as their distribution.

The idea regarding the nature of the human being in the Social Market Economy rests on the assumption that an individual economic actor's dominant primary impulse is self-interest, followed by a strong, but subordinated, secondary social instinct of interest in the other. In other words, the principles of individuality and self-interest dominate over the principles of collectivism and solidarity. This idea calls for a State which, as opposed to focusing exclusively on market freedom as in laissez-faire liberalism or distribution as in socialism, on balancing the freedom in the market with equitable social development. The market is supposed to be ordered such that it becomes a vehicle of equitable social development. Contrary to the night watchman State in laissez-faire liberalism and the central planner State in socialism, the Social Market Economy calls for a referee State which guarantees all economic actors a level playing field. This has been famously stated by Ludwig Erhard (1958) as follows:

I believe that, as the referee is not allowed to take part in the game, so the State must not participate. In a good game of football it is to be noted that the game follows definite rules; these are decided in advance. What I am aiming at with a market economy policy is - to continue with the same illustration - to lay down the order and the rules of the game. (Erhard, 1958)

In order to ensure a level playing field, the State in the Social Market Economy needs to assume responsibilities which go far beyond the night-watchman State's minimalist role and which have nothing in common with the central planner State's micro-management of all economic affairs. The role of the State is not defined by doing almost nothing, or almost everything, but by creating an order for economic activity. This order is much more regulated than in laissez-faire liberalism, yet without the State becoming an economic player as in socialism.

### **1.3 Experimental Economics and Social Market Economics**

Which idea regarding the nature of the human being is correct? Experimental economics supports Social Market Economics, specifically through their experiments that are known as ultimatum games. In a simple ultimatum game, an experimenter appoints two players, an allocator and a recipient. The experimenter gives the allocator a pie to redistribute, let's say US\$ 10. The allocator then needs to offer a certain share of the pie to the recipient. The recipient can either reject or accept the share proposed by the allocator. If the recipient accepts the allocator's offer, the two players can keep the money according to the split which was agreed upon. Yet, if the recipient rejects the allocator's offer, no player receives anything. This setup of the game is known by both players.

Laissez-faire liberalism based on the pursuit of pure self-interest would now predict that the allocator offers only one cent and that the recipient would accept this meagre offer. This is because it is assumed that whatever makes two players better off is also what will be realized. By offering and accepting one cent, both players will be better off than not agreeing to this deal. Because the allocator has redistributive power and wants to maximize utility, the allocator wants to keep the maximum share of the pie, which is US\$ 9.99. Similarly, the recipient is better off by receiving one cent for free and will therefore agree to the offer. This, at least, is what the theory of pure self-interest would predict. Socialists, on the other hand, would hope that the allocators would split their pie equally with the recipient.

So what do the experimental results suggest? Oosterbeek et al (2004) have surveyed 75 ultimatum games played in 26 countries and reported the average offer shares and average rejected shares by country. The findings reveal that the allocators offer on average close to 40% of the

pie while the average offer rejected is about 15%. These experimental results therefore suggest that the idea regarding the nature of the human being is indeed best captured by the assumption that human beings are concerned with both the pursuit of self-interest and concerns for solidarity and equitable socioeconomic development. According to the findings from experimental economics dealing with ultimatum games, one could say, as a rule of thumb, that most individuals give the pursuit of self-interest a weight of around 60% and the concern for solidarity a weight around 40%. Regardless of the exact numbers, what is probably safe to conclude is that people are not completely consumed by any of the extremes pure self-interest or exclusive subordination to solidarity (Oosterbeek, H., Sloof, R. and Van de Kuilen, G. , 2004).

The assumptions regarding the idea of the nature of the human being are very important for political-economic designs. Socialism ultimately collapsed because the idea regarding the nature of the human being, which determined the economic design, did not match human beings' behaviour in reality. Similarly, laissez-faire liberalism, which is built around an idea that human beings are exclusively consumed by self-interest, may experience political turmoil if the constitution and political decision-making process ignores people's demands for equitable social development. Social market economics, on the other hand, operates with an idea regarding the nature of the human being that is most realistic.

## **1.4 Economic Systems and Perspectives on Justice**

Differences between the Social Market Economy, socialism, and liberalism can also be illustrated by the different interactions between economic and justice systems. Central to all three economic models is the importance of efficiency, distributive, and equal opportunity justice. Efficiency justice means that greater productivity should translate into higher pays. The major justification for efficiency justice is incentive compatibility. Distributive justice expresses a desire for an equal distribution of income. The major justification for equal distribution justice is social peace. Last but not least, equal opportunity justice postulates the absence of any discrimination in the access to free, competitive, and open markets. The justification for equal opportunity justice is fairness.

In the view of laissez-faire capitalism, equal opportunity justice is a natural state of free markets and efficiency justice a natural right.

Efficiency justice is necessary for economic actors with greater productive capabilities to also have an incentive to exploit these capabilities. Distributive justice is then always a natural state of a competitive economic order. Whatever distribution results in a competitive economic system, it must be just because it is the result of individuals' free choice in a world of (allegedly) equal opportunity.

For socialists, equal opportunity justice is not a natural state of the free market. Neither is efficiency justice a natural right. Efficiency justice inevitably leads to distributive injustice, which is a non-natural state. Therefore, a central planner needs to plan the production and distribution of all goods and services. Neither is equal opportunity justice a natural state of the competitive market system, but a natural right that government needs to enforce. The central planner allows for equal opportunity justice through public investments in access to education and health so that all individuals have the same chance in rising to a certain job as provided by the central production plan.

The primary objective in a Social Market Economy is equal opportunity justice. As opposed to laissez-faire liberalism, however, Social Market Economists do not believe that equal opportunities are naturally ingrained into competitive markets. Especially markets for the acquisition of market access capital such as health, education, and credit are discriminatory. Children born to landless peasants will have less opportunities to acquire market access capital than children born into the aristocracy. Government therefore needs to correct market failure in markets for the acquisition of market access capital. Once equal opportunity justice is assured, however, efficiency and distributive justice naturally follow.

## **1.5 Ecological Component**

The integration of ecological sustainability in the market economy system is essential to the renewal of SME to Social and Ecological Market Economy (SEME). This component was introduced in the 1990s, much later than the other two components (late 1930s). In the formulation of political decisions, quantitative growth has been the central focus of economic policy. It is well known that ecological aspects are often overlooked in everyday political decision-making.

The modern economic system has been characterized by an unprecedented consumption of natural resources which, together with globalization, has



contributed to an increased reliance on the environment. It is important to mention that it is the global market that has jeopardized nature in its efforts to satisfy the desire for economic growth. Under the SME framework, the objective of the ecological component is to ensure viability on Earth, especially for human life, and do so in accordance with the operative principles of the other components previously presented.

In the liberal economic model, sustainability exists as long as it pays off or contributes to competition. On the other hand, Social Market Economy promotes cultural and political sustainability, recognizing and politically enforcing growth limits (Evangelical Church of Westphalia, 2007).

The ecological component is a relatively new branch of SME. Principles are currently being analyzed and implemented in SME to counteract the impact of human activities on the environment.

- Resources for human activities. The Earth has the capacity to produce goods and generate services without diminishing this capacity, especially when renewable resources are being used.
- Encourage ecological sustainability in economy formation. Economic development is not allowed to flourish at the expense of the environment, therefore economic politics must be directed towards preserving the natural resource base, creating the conditions in which there are incentives to preserve the environment and ensure international standard for policies. The protection and sustainability of the eco-systems should use eco-efficient methods and renewable energy resources (Federal Ministry for Economic Cooperation and Development, n.d.).
- A balanced application of policies. The use of the three components (market, social, and ecological economy) of the SEME must reconcile the needs of the economic activities, must enable social demand and prevent climate change from worsening (Asmussen, 2014).

Benedict XVI in *Caritas In Veritate* (50 51) wisely expresses, regarding what is expected from the consensus among components of the [ESM] on the environmental issues:

“The international community and individual governments will succeed in countering harmful ways of treating the environment. It is likewise incumbent upon the competent authorities to make every effort to ensure



that the economic and social costs of using up shared environmental resources are recognized with transparency and fully borne by those who incur them, not by other peoples or future generations: the protection of the environment, of resources and of the climate obliges all international leaders to act jointly and to show a readiness to work in good faith, respecting the law and promoting solidarity with the weakest regions of the planet...The way humanity treats the environment influences the way it treats itself, and vice versa. (Benedict XVI, 2009)

## 2. The Role of the State in a Social Market Economy

### 2.1 Overview

Walter Eucken (1891-1950), like no other scholar, gave answers to the question of what the role of the State has to be in order to translate the normative ideal of a Social Market Economy into political practice. He coined the result of this translation process ordoliberalism.

The purpose of a Social Market Economy, like the one of any other modern economic system, is to allocate limited scarce resources efficiently to serve people's unlimited needs. In other words, consumer sovereignty drives economic activity. The only economic model that truly guarantees consumer sovereignty is perfect competition, which always has been the guiding framework for ordoliberalism.

Ordoliberalism describes the role of the State in ordering the market such that it meets the ideal of perfect competition. For this order to be consistent with the idea of perfect competition, ordoliberalism answers four questions: (1) How is the State supposed to be organized? (2) What are the rules guiding market activity? (3) When does government need to interfere into the market? And (4) How is the government supposed to interfere into the market?

As far as the organization of the State is concerned, Eucken favors a State which is democratically organized around the subsidiarity principle and insulated from special interest groups. Market competition among economic actors is not compatible with a central planner system. Eucken calls this the interdependence of orders. Democracy is a necessary complement to a competitive economic order. Without democratic decision-making processes, priorities for the provision of public goods that best supplement private economic activities can barely be identified. Subsidiarity additionally assures that no larger group becomes involved in the affairs of what a smaller group can handle more effectively.

As for the actual conduct of economic policy, Eucken highlighted two state-political principles: (1) The dissolution of market power and (2) the primacy of order over discretionary policy. The dissolution of market power calls for two governmental responsibilities. Firstly, government needs to order the market such that the rules of the game are conducive to the emergence of perfect competition. Secondly, government needs

to stop the game whenever a particular market fails to allocate scarce resources efficiently or market dynamics generate a development of income that contradicts the normative objective of equitable social development. The primacy of order over discretionary policy describes the principles according to which government should intervene in markets.

## 2.2 Subsidiarity

Subsidiarity regulates the division of labor between smaller and larger groups within society. It states that whatever the individual or the smaller group can do more effectively must not fall under the jurisdiction of a larger group. The principle of subsidiarity is central to the Catholic Social Teaching, which has a strong influence on Social Market Economic thinkers. The Catholic Church saw in the principle of subsidiarity the counter argument to socialism's claim that only collectivism and central planning could assure social justice, not a well regulated market system. In the words of Pope Pius (1857-1939):

... it is an injustice, a grave evil and a disturbance of right order for a larger and higher organization to arrogate to itself functions which can be performed efficiently by smaller and lower bodies. This is a fundamental principal of social philosophy, unshaken and unchangeable, and it retains its full truth today. (Barrera, 2001)

The subsidiarity principle has several policy applications. One refers to the design of social safety nets and mandates help-to-self-help. This means that an entitlement for solidarity is only legitimate after the individuals in need of help exhausted the means to help themselves. This principle can also be found in the Bible, where it says in 2 Thessalonians 3:10 that "the one who is unwilling to work shall not eat." The principle of help-to-self-help is also found in modern unemployment support practices where the unemployed must show evidence of actively seeking employment in order to receive unemployment benefits. Another application is the practice of co-payments in insurance plans.

Another important policy application of subsidiarity is federalism. Already in the Old Testament it is described as a political organization principle. From the book of Exodus we know that Moses found himself overwhelmed with solving judicial conflicts among the Israelites. His father-in-law, Jethro, then advised him to appoint subsidiary judges and to "teach them his decrees and instructions, and show them the way they are to live

and how they are to behave” and to let them serve “as officials over thousands, hundreds, fifties and tens.” Moses abided by Jethro’s advice. As a result, “difficult cases they [the newly appointed judges, authors] brought to Moses, but the simple ones they decided themselves” (Exodus 18:20-22).

While the term subsidiarity does not appear as such, the concept is also addressed in the Federalist Papers. Alexander Hamilton (1755-1804), for example, wrote in 1788 “that acts of the large society which are not pursuant to its constitutional powers, but which are invasions of the residuary authorities of the smaller societies” will not be part of the “supreme law of the land.” Later, Abraham Lincoln (1809-1865) wrote:

The legitimate object of government is to do for a community of people whatever they need to have done but cannot do at all, or cannot so well do for themselves in their separate and individual capacities. In all that people can do individually well for themselves, government ought not to interfere. (Nicolay, J. and Hay, J. (Editors), 1907)

## 2.3 The Market Constituting Principles

As for the market constituting principles, Eucken notes that the government needs to guarantee a set of business freedoms and business climates, which are: (1) Free price formation, (2) free trade, (3) free contracts, (4) private property rights, (5) private liability, (6) price stability, and (7) a predictable course of economic policy. The fundamentals (1) to (3) can be interpreted as business freedoms, the fundamentals (4) to (7) as business climates.

Free prices are necessary to allocate scarce resources efficiently. In a perfectly competitive market, which is what Social Market Economists envision, prices are formed by the invisible hand of the market. Profits that exist in the short run will be eliminated by market entries and zero economic profits will prevail in the long run – a process famously called by Joseph Schumpeter (1883-1950) as “creative destruction.” Under perfect competition, once the market is in its long run equilibrium, markets clear with all firms operating using existing technologies most cost effectively.

Government often does not tolerate the price formation mechanism for alleged social policy objectives. Regulatory authorities may impose price

ceilings to hide inflation or to protect consumers, or it may impose price floors to protect producers. Of course, neither are price controls effective in fighting inflation and to cover up for irresponsible fiscal policy, nor are price controls an effective mechanism to protect certain consumers or producers. Instead, price controls reduce economic activity, promote allocation inefficiency, cause a deadweight loss, and are a costly means of social policy because of their high inclusion error.

Free trade increases the size of the market and large competitive markets increase consumers' and producers' sovereignty, both of which again increase welfare. Free trade, however, not only creates winners but also losers, and even though economic theory and empirical evidence clearly shows that the winners will win more than what the losers will lose, any commitment to free trade is also a challenge to social policy. The undisputable aggregate welfare gains from open borders must not be sacrificed for the sake of preventing adverse redistributive implications, but used to support effective social safety nets and to increase aggregate welfare.

For perfect competition to unfold, freedom of contract is a necessary, though not sufficient, condition. For example, farmers who are forced to sell their produce to a governmental marketing board at a fixed price cannot compete against each other, and will have very little incentive to work as efficient as under perfect competition. But freedom of contract can also be used to undermine competition, especially in markets where economic actors have market power. For instance, freedom of contract in a labor market characterized by a demand monopoly would allow the monopsonist to push down wages to workers' reservation price. This will generate less welfare for workers and the economy as a whole than would be the case in a competitive labor market. Likewise, freedom of contract must not be used to restrict competition through cartel agreements, tie-in sales, or market segmentation. In a Social Market Economy, freedom of contract can only unfold its competition-stimulating effects in combination with an effective antitrust and competition policy.

Secure and tradable private property rights are essential for land and (real) capital markets to work efficiently. Without secure and tradable private property rights, market prices cannot form, incentives for efficient production are not given, and resources become over-exploited (tragedy of the commons). In the case of absent land titles in particular, landless peasants will be unable to escape poverty. As long as they cannot offer any collateral, they will remain excluded from financial markets.

Private liability means that in a market system not only profits are private, but also losses. If private liability is no longer given, and government bails out failing companies, government overrules the selection test of the market and mandates that inefficient resources are kept being employed. A society in which all firms are insured against losses must necessarily turn into a casino economy in which ever greater risk-taking becomes a dominant strategy to make profits, but business failures create ultimately losses that will exceed a society's bail-out capacities.

Price stability means that there is neither unexpected inflation nor deflation beyond reasonable levels. Acceptable rates of price changes over a year are typically seen at around two percent. Unexpected inflation or deflation acts like a veil of uncertainty over economic activity. Specifically, when central banks' inflation tolerance is greater than the one expected by economic actors, wages not only increase to reflect greater productivity, but also to anticipate a higher inflation tolerance. The result is a wage-price spiral. Similarly, unexpected deflation causes consumers and firms to hold back planned spending in anticipation of prices falling even more, leading to a self-fulfilling prophecy. As aggregate demand falls, companies incur losses, which they try to reverse by lowering prices even more. The process continues until companies go bankrupt and banks fail.

Common to all the business climates and freedoms is the more general concept of a predictable economic policy. Predictability is necessary for economic actors to engage in long-term investments, which are often undermined by ad-hoc economic policy changes and policy interventions.

## **2.4 Correcting Market Failures**

Social market economists acknowledge four events when government needs to interfere. They are (1) abnormal labor supply functions, (2) inequitable social development, (3) market power, and (4) so-called externalities.

Abnormal labor supply functions occurred during the industrial revolution when fast rural-urban migration let the labor supply grow faster than labor demand and caused wages to spiral downward. Workers responded to falling wages by offering their employers to work longer hours, and to even have their children work for them too. The result was that workers and their families impoverished. For Social Market Economists, the observation of abnormal labor supply functions is therefore a red flag to

respond with social security systems. In modern contexts, abnormal labor supply functions are often revealed by the presence of child labor.

Inequitable social development is a concern, which hints at inequitable access to markets for the acquisition of market-access-capabilities. Market-access-capabilities are embedded in education, health, and access to finance. Markets for the acquisition of market-access-capabilities do not reach everyone, which is why social market economists advocate for complementing markets for the acquisition of market-access-capabilities with public schools, health care, and State-owned banks.

Market power in the form of monopolies or cartels undermines consumer sovereignty and creates economic outcomes, which do not employ scarce resources efficiently and do not maximize welfare. An effective competition policy is therefore necessary.

Externalities are problems resulting from the overexploitation of natural resources. The basic problem with externalities is that land, water, and air resources are used as a reservoir for pollutants in the production process, which adversely affect other economic actors. Externalities are the result of the absence of any market regulations regarding the externality-transmitting resources, which is why an expansion of the market-constituting principles to these areas is necessary.

## 2.5 Interfering into Markets

How is the State supposed to interfere into markets whenever it is confronted with either market failures or inequitable income developments? The overarching principle of how to interfere into markets is Eucken's second state-political principle of a primacy of order over discretionary policy. A prime example of order vs. discretionary policy can be found in traffic regulation. A policeman regulating traffic would be the counterpart to discretionary policy while traffic rules like first-come-first-go at an intersection with a stop sign would be the counterpart to a rules-based policy. Other examples of the primacy of order over discretionary policy are (1) The avoidance of sector interventions, (2) Market conform social and environmental policies, and (3) Limited use of stabilization policy.

The argument in favour of the avoidance of sector interventions is at least twofold. First, an industry that struggles with passing the selection test of the market must use its resources inefficiently and a sector



intervention is technically a subsidy of inefficiency. Second, any government intervention to support the competitiveness of one sector of the industry must come at the expense of the well-being of another one.

Market conform social policy means that government must not manipulate markets prices. Social policy that uses government prices to accomplish redistributive effects like, for example, a price ceiling will reduce quantity supplied and therefore economic activity, which causes a deadweight loss. Price-ceilings to target economically vulnerable segments of the society also benefit those that are not vulnerable, thus causing an inclusion error. Only targeted social assistance programs are in line with market-conformity of social policy, ideally through cash transfers. Often, in economic policy practice, targeted social assistance programs have a great exclusion error, meaning that many who should receive social assistance are not identified. Market-conform social policy therefore requires an effective public administration.

Market-conform environmental policy is about establishing prices for resources that are being overexploited. For this purpose, government could either levy a tax on the emission of pollutants or create an emissions market. The superior solution is the emission market. Why? When it comes to an environmental problem, it is possible for natural scientists to determine a level of pollution that is environmentally sustainable. For this optimum quantity it is then possible to auction off tradable emission certificates so that an optimum price will be endogenously determined. The problem with the tax solution is that it is much more difficult to determine in advance a tax from which then an optimum emissions quantity will follow.

The moderate use of stabilization policy is the result of a rather anti-Keynesian philosophy. Social market economists argue that if all Social Market Economic principles are followed, no situation should arise that would require excessive stabilization policies. When all markets work well, unemployment should not become a serious problem and if a cyclical downturn occurs, the social costs should be cushioned by targeted social safety nets, not ad-hoc governmental rescue missions. Targeted social safety nets like unemployment or invalidity insurance are built-in automatic stabilizers that reflect prudent and conservative planning for the future.

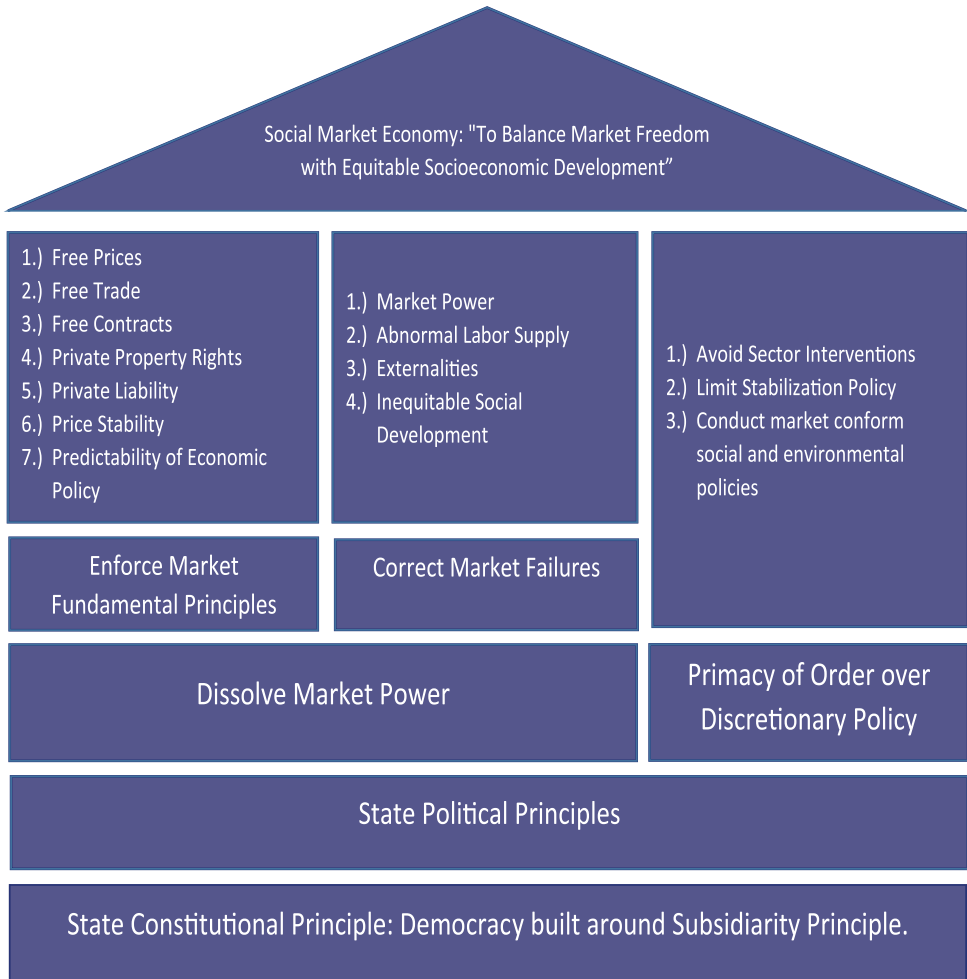
In addition, social market economists have adopted the Austrian criticism that stabilization policies undermine the self-healing mechanisms of markets. To illustrate this, consider the case of an inflationary policy to



reduce inflation. As prices for goods and services go up overnight, wages tend to be sticky because workers have long term contracts. This means that when there is inflation, the prices for goods and services produced by the workers increase, but their real wages decrease. In other words real profits increase. The Keynesian logic is now that these inflation-induced profits cause firms to hire more people. The problem with this view, however, is that the central bank's discretionary impulse it is not time-consistent. Workers will eventually re-negotiate their wages and then argue that they would not only want to be compensated for an increase in productivity, but also for inflation. Workers will then form inflationary expectations that will let wages grow far beyond productivity gains. Then, if the central bank wants to replicate its inflationary growth stimulus, it would have to create even higher inflation rates than at the first time. The result is a price-wage spiral which will distort economic activity more and more.

Figure 1 summarizes the Social Market Economic principles in the form of a house. Its fundament is the State constituting principle of democratic practice organized around the subsidiarity principle. Built upon this fundament, the two state political principles of the "dissolution of market power" and the "primacy of order over discretionary policy" guide state-political actions. The dissolution of market power is both a commitment to the ideal of perfect competition and to the fact that markets can fail and require regulation. Once markets fail, the primacy of order over discretionary policy must guide government action to correct unwelcomed market dynamics. If a State succeeds to implement successfully these principles, it manages to balance the freedom with equitable social development.

**Figure 1: Summary of Social Market Economic Principles**



Note. Marktanner (2015).

### 3. Consistency of the Guatemalan System with SME principles

According to von Hoegen (2015), as illustrated in the following table, the Guatemalan Political Constitution is consistent with SME objectives and operative principles, including the required limitations, with the exception of the social component in which no limitations are considered (von Hoegen, M., 2015).

**Tabla 3. Social Market Economy objectives and operative principles: the Guatemalan Political Constitution**

<b>Pre-requisites or preconditions</b>	<b>Articles</b>
Pre-requisite: Representative democracy <sup>19</sup> , exists, in order to reach national consensus on economic and social policies.	136, 140, 141, 223 17 final provisions and transitional rules
Pre-requisite: Strong State to guarantee the rule of law and the implementation of consensual economic and social policies –Ordoliberalism- .	2, 118; 119 sub-paragraph 121, 122, 123, 125, 126, 127, 128, 129, 131, 133, 138, 139, 140, 153, 171, 183, 232
<b>Fundamental objective</b>	<b>Articles</b>
Recognition of SME fundamental objective: mankind must be the center of society, given the fact that it is the center of creation.	Invocatory; 1, 2, 3, 44
<b>Economic Component objective</b>	<b>Articles</b>
The production of the highest possible level of income and wealth, at the lowest possible cost.	
<b>Economic Component operative principles</b>	<b>Articles</b>
Economic or market freedom, with responsibility and therefore private liability; the freedom includes:	4, 5, 26, 43, 102 sub-paragraph a, 150
- Prices are set by the market, based on supply and demand	
- Free trade	
- Contracts are settled freely	
Private property	39, 41, 42, 67, 102 sub-paragraph e. 243
Only the private sector produces goods	
generates services	45
Macroeconomic stability	119 sub-paragraph, 132, 133

<sup>19</sup> Representative democracy is a product of general elections and is complemented by participatory democracy or citizens' regular participation in local issues.

## **Limitations to Economic Component operative objectives**

	<b>Articles</b>
Economic and market freedom:	77, 06, 101; 102
- Prices are set by the market, based on supply and demand.	sub-paragraphs C. E, f, g, h, i, j, k, l, o; 103, 106;
- Free trade	119 paragraphs h,i;
- Contracts are settled freely	130
Private property and therefore private:	40, 120, 121, 122,
- In cases of public need, expropriation is a need.	123, 127, 128, 142
- In case of extreme concentration of income and wealth, redistribution is needed.	
Only the private sector produces goods or generates services	118
Macroeconomic stability	132 sub-paragraph a

## **Social Component objective**

The satisfaction of all human needs: physical, cultural and spiritual.

## **Articles**

## **Social Component operative principles**

	<b>Articles</b>
Freedom with liability for consequences	4, 5, 26, 35, 36, 63,
Solidarity	73, 102 sub-paragraph a
	1, 4, 44, 51. 52, 53,
	67, 68, 69, 71, 93, 94,
	99, 100, 101: 102
	sub-paragraphs i, j,
	k, l, m, o; 105, 106,
	115, 118: 119 sub-
	paragraphs d, e, g, j; 242
	4, 94
Equal opportunities for all	
Subsidiarity:	28, 30, 31, 33, 34, 37,
- humankind,	45, 47, 58, 66, 67,
- family	68, 76, 90, 92, 98,
- community,	101, 102 sub-paragraphs
- municipality and	q; 119 sub-paragraphs
- intermediate government between municipal and national levels	b, f; 134, 137, 152.
	173, 224, 226, 228 –
	231, 237, 241, 242,
	253-257, 259-262,
	277 literal d; 13, 18
	final provisions
	and transitional rules

## **Limitations to Social Component operative principles**

## **Articles**

Solidarity:

- viability of the economies: the amount of resources that can be assigned to social programs and projects;
- the need to avoid a culture of paternalism or making beneficiaries permanently dependent on dependent on social help

Equal opportunities for all:

- See limitations to operative principles above  
ciudad arriba

Subsidiarity:

- When a lower level is incapable of solving a problem, a higher level must intervene to solve it

2 of the chapter that includes the final provisions and transitional rules

## **Ecological Component objective**

## **Articles**

The assurance of the viability of life on Earth, especially for the human life; and with a quality consistent with the operative principles presented for the Economic and the Social components

64, 97, 119  
sub-paragraph c

## **Ecological Component operative principles**

## **Articles**

Sustainability of the planet/of the capability of production Prioritize distribution instead of production vis-a-vis high levels of waste and pollution

125, 126

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Source: La Economía Social de Mercado (ESM) en la Constitución Política de la República de Guatemala, von Hoegen 2015.

Another important piece of legislation is Decree No 7-2013, dated September 5, 2015, the "Framework Law to Regulate the Reduction of Vulnerability, Compulsory Adaptation to the Effects of Climate Change, and Mitigation of Greenhouse Gases".



## Parte III: **Effects of SEME on the country, some examples:**

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### **1. Employment**

The Republic's Political Constitution recognizes work as a person's right and as a social duty taking in consideration (collecting) the principle of subjectivity and objectivity of the work organized by a labor regime in accordance with principles of social justice. Constitutional law is developed in ordinary legislation that socially and legally delimits the rights and obligations of the right to employment prior to the labor law of the activity of employers and employees, not only domestically but at an international level. This legal framework is comprised of: the Political Constitution of the Republic, section 8, articles 101-106, which establishes minimum employee rights, and section 9, which stipulates State employee rights; the Labor Code and its reforms; the Executive Law, section 2, specifically articles 40; and various conventions and treaties ratified by Guatemala. Furthermore, the Ministry of Labor and Social Security (MINTRAB) is tasked with directing, researching, and settling all matters related to work, social security, labor and salary policies, occupational health and hygiene, as well as complying with the labor-related legal regime and technical and professional training.

#### **a) Political Constitution of the Republic of Guatemala**

The Constitution establishes that work is a personal right and social obligation; therefore, a legal framework is needed to regulate and define certain aspects so that labor relations are respectful, harmonious, productive, and beneficial for all stakeholders: employees, employers, and Guatemalan society. The Ministry of Labor and Social Security in the public entity tasked with ensuring that employee-employer relations are carried out in accordance with the corresponding legal framework for the sake of productivity and social development (Congreso de la República de Guatemala, n.d.).

## **b) Labor Code**

The Labor Code regulates employer and employee rights and obligations and creates dispute settlement institutions<sup>20</sup>, such as the Ministry of Labor and Social Security. Guatemalan labor legislation is based on a number of principles called ideological characteristics in the Labor Code, some of the most prominent of which are: (Congreso de la República de Guatemala, n.d.).

- Protective or tutelary principle (article 103 of the Constitution: this principle grants workers preferential juridical treatment to compensate for economic inequality. This principle is, in turn, expressed in other principles).
- Inalienability: this refers to the application of the regulations most favorable for the worker.
- Minimum rights: the compulsory application of minimum benefits established by law.
- Objectivity and realism: particularly applicable to the parties' positions and views.
- Labor law is a branch of public law: private interest must yield to collective interests.
- Labor law is deeply democratic: it is geared towards the economic and moral dignification of workers.

## **c) Ordinary Laws**

Ordinary Laws related to labor issues include:

- Regulating Law on Christmas Bonuses for Private Sector Workers (Decree No. 76-78).
- Law on Yearly Bonuses for Private and Public Sector Workers (Decree No. 42-92).
- Law on Yearly Incentive Bonuses (Decree No. 78-89).
- Guatemalan Social Security Institute Law (Decree No. 295).

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20 Decree number 1441. Labor Code, article 1

In addition to the Constitution, the Labor Code, and ordinary laws, there are a number of regulations in the general structure of labor law which regulate and help enforce the law in labor-related matters, such as<sup>21</sup>:

- Regulation on breastfeeding provisions.
- Regulation on the procedure for negotiating, standardizing, and denouncing collective agreements on labor conditions in private companies or production centers, etc.

Specific labor legislation includes:

- Individual work contracts
- Internal labor regulations
- Working conditions collective agreement
- Working conditions collective convention
- Labor law principles
- Customary or local uses
- Common law principles and laws

In general terms, this legal framework is satisfactory. However, there are certain conflicts with regard to issues such as yearly minimum wage agreements, the acceptance of the part-time regulation, enforcement of labor laws in the informal sector of the economy, as well as the enforcement of the regulation of working minors, and others.

#### **d) International Labor Organization Conventions ratified by Guatemala**

The International Labor Organization (ILO) was created in 1919 and is the oldest United Nations system. It is unique in that it is a tripartite structure, in which government representatives, employers, and workers all participate on equal grounds as constituents. Its main objectives are to promote labor rights and the creation of decent jobs, improve social security measures and strengthen dialogue on labor issues (Linares, 2000).

ILO conventions address a wide range of topics, and can be divided into three main groups: fundamental conventions, priority conventions, and thematic conventions.

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<sup>21</sup> Domestic legislation on labor and social security matters. Training provided under the AdA-Integration Project, March 2014



1. Fundamental conventions are those that address issues considered to be fundamental principles and rights: Forced Labor Convention, 1930 (No. 29), Freedom of Association and Protection of the Right to Organize Convention, 1948 (No.87), Right to Organize and Collective Bargaining Convention, 1949 (No.98), Equal Remuneration Convention, 1951 (No. 100), Abolition of Forced Labor Convention, 1957 (No.105), Discrimination (employment and occupation) Convention, 1958 (No. 111), Minimum Age Convention, 1973 (No. 138) (Specified Minimum Age: 14), and Worst Forms of Child Labor Convention, 1999 (No. 182), among others.
2. Priority conventions address social justice for fair globalization as the standards that are most significant from the viewpoint of governance: Labor Inspection Convention, 1947 (No. 81), Employment Policy Convention, 1964 (No. 122), Work Inspection (agriculture) Convention, 1969 (No. 129), and Tripartite Consultation (international labor standards), 1976 (No. 144), among others.
3. The remaining conventions are grouped by topic, as follows:

**Table 4. Remaining ILO conventions by topic**

Non-fundamental human rights	Work administration
Employment of children and youth	Indigenous and tribal peoples
Employment	Work relations
Employment of women	Migrant workers
Social policy	Working conditions
Social security	

Source: ILO

Guatemala has ratified 73 of 189 ILO conventions. There are 68 in effect, 4 of which have been denounced, and none have been ratified in the last 12 months (ILO, 2012). The denouncements were made at the beginning of the 1990's and were on the following conventions: Minimum Age (agriculture) Convention, 1921 (No. 10), Minimum Age (trimmers and stokers) Convention, 1921 (No. 15), Safety Provisions (building) Convention, 1937 (No. 62), and Statistics of Wages and Hours of Work Convention, 1938 (No. 63).

Another point to bear in mind is that sector indicators show that in recent years no significant changes have been reached so as to improve equality and wellbeing among the working class. According to INE's employment statistics, unemployment rates between 2002 and 2014 ranged from 4.1% to 2.9% (INE, 2014). Furthermore, there are still gender issues to deal with, as the unemployment rate among men is lower than among women.

Employment is classified as formal or informal, the latter being most prevalent, at 67.6% in 2014<sup>22</sup> (INE, 2014). It is interesting that rural areas have the highest unemployment rate, at 81.2% in contrast with urban areas, at 52.8%. Lastly, monthly work revenue has not grown significantly and is still below the cost of the basic food basket (Q.3,236.70) and the basic goods and services basket (Q.5,906.39) (INE, 2014). In 2014, average income was at Q.2,207.00. (INE, 2014). Occupational earnings tend to be greater in metropolitan areas (Q.2,930.00) and urban areas in the provinces (Q.2,671.00) than in rural areas (Q.1,470.00). Once again, gender and racial differences are prevalent, with men earning more than women, and non-indigenous earning more than indigenous people.

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1 The data was obtained from INE's virtual database (last update on 2014 when checked): employment statistics and Consumer Price Index (CPI) (INE, 2015).

## 2. Price-cap liberalization<sup>23</sup>

Before developing this section it should be noted that SME is not a closed system, it is not rigid and neither is rooted in an ideology, it is a system with premises to regulate the economy and society through flexible and effective means and resources in view of broad challenges and developments. Thus combines market economy with state measures to prevent or mitigate unintended or socially unsustainable consequences; Ludwig Erhard considered that the economic activity after all, has the purpose of creating welfare for all, from there it must be coordinated to harmonize the scarcity of goods with the satisfaction of society's needs, within a juridical order "on a social, ecological and economical well-balanced base" (Thesing, 2009)

A free market is one in which providers do not set prices but rather accept the equilibrium price. Buyers and sellers should not influence price setting, rather it should not matter who buys or sells; as long as the products or services are homogeneous, there should be full awareness of market conditions and free flow of productive resources. Likewise, entering and leaving the market should not be an onerous process (Duri, 2012).

Prices act as indicators of the relative scarcity of goods and services. For producers, prices provide information on production costs and indicate buyers' willingness to pay, as well as how much they value the good or service. In this sense, prices indicate to market agents the products, volumes, and quality that should be produced (Resico, M., 2011). In real life, there are no perfect competitive markets; there are always failings which, according to economic theory, are some of the most frequent justifications for State intervention. In some cases, market failures prevent the price system from functioning as expected, and since it cannot provide economic agents with correct information on the costs or benefits of their choices or actions, the redistribution of income via the market breaks down or does not occur (Resico, M., 2011).

The State regulates market prices through economic policies. However, these actions generate effects that can distort the course of the market, the economic agents' actions, and economy in general. One of these

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1 This section is a summary of a study by Claudia García Mancilla, an ASIES researcher, entitled "*Liberalización de precios tope en Guatemala*" (*The Liberalization of Price-caps in Guatemala*).

measures is the implementation of price caps, which is a social policy aimed at benefitting under-privileged sectors of the population. State intervention through the implementation of price caps is only considered necessary when there is a consensus among the government, producers, distributors, and consumers and the necessary controls are implemented to ensure supply and prevent shortages of the products subject to this measure. Price control can have a distortive effect on the economy, especially on the supply and demand of the goods and services involved. Supply often drops, as there is less motivation to produce said products, especially when the set price does not even cover production costs. The price of goods and services is subject to the interaction of supply and demand, a game which should in itself be able to maintain satisfactory prices for both consumers and producers, but when price caps are introduced, consumers are the only ones satisfied and suppliers often stop producing, researching, and innovating.

At the beginning of the 80's, global economy went into a recession. In Guatemala, this period marked the beginning of a time of both economic and political crisis. Economic growth rates stayed low, primarily because of the global economic slow-down and the heightening of social and political tensions linked to violence and the armed conflict taking place in the country at that time. The situation reached critical levels in 1983; the government was forced to cut expenses even further and proposed a tax reform in order to secure enough resources to reactivate the economy (Guerra Borges, A., 2011). However, this caused even greater strife between public and private sectors: the private sector opposed the reform and the result was an even more regressive reform<sup>24</sup>, with a less progressive income tax rate<sup>25</sup> and a heavier indirect tax burden with the creation of value added tax (IVA).

Although State revenue did pick up slightly, in 1985 the economic situation experienced another dramatic slowdown as a result of general price increases coupled with never before seen inflation rates. In light of the situation, the government decided to implement three<sup>26</sup> economic policies, the first of which dealt with price caps for a variety of products (Guerra Borges, A., 2011). In 1985, national currency steadily depreciated, affecting imported goods and consequentially causing an unprecedented spike in general prices of domestic products (the inflation rate closed out

24 A regressive tax system in one in which tax rates decrease as income increases.

25 Progressive taxes are those that have higher rates for brackets with higher incomes.

26 The other two were an exchange rate alignment and the issuance of bonds in national currency and U.S. dollars. The government did not endorse exchange rate unification, since there were various currency markets.

at 18.7%), as well as growth in means of payment, which in turn had repercussions on the employment rate, production in general, consumption expenditure, and private investment.

In 1985, Decree-law 1-85, the Consumer Protection Law, was issued with the objective of controlling and preventing immoderate increases in the prices of certain essential products and services. Additionally, the Regulation on the Consumer Protection Law by Governmental Agreement No. 48-85 was also issued to regulate maximum sales prices. The following table includes a list of said products:

**Table 5. Types of products regulated through price caps**

1. Beef	23. Vinegar
2. Pork	24. Juice
3. Beef offal	25. Tomato paste
4. Basic cereals	26. Industrialized generic chicken
5. Pasteurized milk	27. White eggs in bulk
6. Wheat flour	28. Incaparina
7. Generic sausages	29. Whole powdered milk
8. Vegetable oil	30. Instant powdered milk
9. Salt	31. Toothbrushes
10. White sugar	32. Detergent
11. Margarine base or hydrogenised oil	33. Laundry soap
12. Margarine	34. Bar soap
13. Vegetable shortening	35. Sanitary napkins
14. Packaged pasta	36. Disinfectant powder
15. Sandwich bread	37. Toilet paper
16. Generic bread	38. Paper napkins
17. Roasted and ground coffee	39. Matches
18. Instant coffee	40. Candles
19. Oatmeal	41. Dry batteries
20. Yeast	42. Shoe polish
21. Baking powder	43. Razor blades
22. Corn flour	44. Light bulbs

Source: Regulation on the Consumer Protection Law by Governmental Agreement No. 48-85.

These main categories contained a total of 445 regulated products. Maximum sales prices were set for retailers and end users and were measurement specific. The maximum price set by the government was the maximum price for which a product could be sold and should not be exceeded. The State's intervention in this regard was a measure to slow down inflation and mitigate shortages.

With regard to State intervention on this occasion, internal motivations propitiated the imposition of price caps, but international conditions were what permitted liberalization of the economy. At the beginning of the democratic period, economic policy was geared towards freeing the market and reducing State intervention, since at first actions were aimed at opening the economy and shifting to a free market economy (Sosa L., 1991). The measures adopted by the State included: liberalizing prices, reducing tariffs, floating exchange and interest rates, increasing public services, and others.

The price liberalization process started with the implementation of a commission comprised of the Ministry of the Economy (MINECO), the General Secretariat for the National Economic Planning Council, and the National Statistics Institute, which reviewed the price caps contained in Governmental Agreement 826-85, dated September 12, 1985, and proceeded to liberalize prices on certain products; however, some articles remained the same and other were adjusted in order to prevent rapid price spikes in the prices of certain basic commodities. This was accomplished through Governmental Agreement of the Ministry of the Economy No. 269-86 which provided for a gradual reduction and elimination of price caps.

The price cap list was scoured in accordance with the results of the National Survey of Family Income and Expenditures (ENIGFAM), which removed from the list all articles which were not popular consumer goods and represented 87% of the consumption in families with incomes below Q.4,800.00. Additionally, prices were adjusted in line with production costs. This measure aimed to reduce market distortions resulting from the State's intervention in imposing price caps. This generated a number of effects, such as shortages, the emergence of an informal market, price discrepancies, and price hikes, among others.

Congress demanded an explanation to the Ministry of Economy in light of all the issues that arose as a result of the price cap liberalization. During the investigation, the Ministry affirmed that the State plays a

subsidiary role in economic activity and it is the individuals and companies that make up free economic activity. It also affirmed that the purpose of freeing prices is to develop a free market in which buyers and sellers can organize themselves to implement policies aimed at scaling up production. The price liberalization policy was influenced by other monetary factors, union pressure, and civil society (housewives), and so, once again some articles were put back on the list of controlled prices. Nonetheless, by the end of the administrative term, only 13 products were controlled.

As previously stated, price liberalization was accomplished gradually and as the result of international pressure and an internal process of democratization. The popularity of the first democratic government eased the process to some degree.

### **3. Environmental overview: natural resources**

It is a universally accepted fact that environmental exhaustion, degradation, and pollution are contributing factors in environmental vulnerability, especially when these factors create synergy with other socio-cultural, economic, and institutional insufficiencies to create systemic vulnerability. In other words, a state of defenselessness that, when combined with other threats, creates risk conducive to disaster.

The term “environmental problems” refers to a set of facts and circumstances that are reflected in exhaustion, degradation, and pollution of the natural environment and which impact social wellbeing and system stability. Environmental problems become crises when it is doubtful that they can be mitigated or eliminated by merely maintaining the same efforts to control them (especially when said efforts are not on par with the magnitude and complexity of the problems, as in Guatemala’s case) (IARNA-URL, 2012).

A first set of environmental problems and crises is linked to extractive activities impacting the environment at the demand of the economy and households (environmental flows to satisfy production and consumption needs). The problem arises when these demands exceed nature’s self-recovery capacities and this can be seen in several ways, such as the exhaustion and steady deterioration of forests and associated wildlife (flora and fauna), soil, water, hydro-biological resources, energy-producing goods, and sub-soil resources.



A second category of problems and crises arises from the inability (or indifference) to manage waste and emissions derived from economic activities and households. Waste is dumped directly onto soil and water and emissions are released into the atmosphere.

The relationship between the environment and the economy and households is inevitable and inherent to humankind's need for space, materials, and energy. However, the magnitude of the impact on the environment and the way it is treated is inherent to the dominant "development pattern"<sup>27</sup>.

Guatemala's Environmental Profile (IARNA-URL, 2012) highlights a number of systemic and operational responses (called structural responses in the report). The first responses are aimed at dealing with the historical-structural causes of environmental degradation and social exclusion, since both are mutually reinforcing, especially now, when climate change and variability heighten society's fatal risk factors. The operational responses are aimed at preventing crises from intensifying and completely destroying the ecosystem's already scarce goods and services. However, these are reactionary measures that will have very little long-term impact, as they are upheld by an institutionality designed to look after other opposing interests and which does not view the environment as a public good.

The deterioration of the environment feeds into local vulnerability which, given that it is in constant synergy with economic, socio-cultural, and political-institutional vulnerability, generates striking levels of defenselessness in different regions of the country. When this is combined with multiple other threats, such as global climate change and variability, high levels of vulnerability to disasters are created, directly affecting people, their livelihoods, and their environment.

Therefore, socio-natural relationships must be redefined in an attempt to find a collectively beneficial model, including the revitalization of strategic ecosystems as needed, not only in the country but in the entire

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27 With regard to Social Economic Formation (SEF) which, according to Palencia (n.d.) refers to the characteristics and relationships related to economic, social, political, and ideological structures, historically built in connection with the economic relationship between paid work and capital in a market environment, which implies a certain political-social organization, as well as forms of institutionalized oversight and control. Although it is based on the idea that the economy does not mechanically determine politics or all social processes, it does condition (or is capable of doing so) democratic action frameworks and political policies and their results, especially in societies that do not have a social State with consolidated rights, but are characterized by operating as corporate patrimonial States. Therefore, SEF does not only relate to accumulation or the economy per se; it also involves juridical structures (reforms or new legislation favoring the development of a dominant economic model), the educational field (training human capital), the ideological structure (through mass media) and even the political arena and citizen participation mechanisms.



Mesoamerican region, as a mechanism to ensure their health and to sustainably provide the goods and services in demand on a daily basis. This revitalization of the ecosystem is also needed in order to ensure the country's resilience vis-à-vis growing risks. Undoubtedly, social empowerment is needed in order to make this a reality based on strengthened public institutionality and productive practices more in line with environmental constraints.

With regard to the state of the natural environment, it seems clear that the current economic growth pattern dressed up in neoliberal doctrine does not take into account socially desirable levels of environmental quality.

Therefore, it is important to make space for an agreement that would foster the following: first, a robust, inclusive, and sustainable economy with an economic matrix more in line with our environmental and socio-cultural features, and capable of internalizing user costs and environmental impact; second, an articulated society with equal opportunities to enjoy full, empowered citizenship with a long-term vision; third, a vision of the environment (and biodiversity) as a public good with strategic value for all life forms; and fourth, autonomous institutions in line with public interest.

So far, the most popular scenario has been that of sustainable development, a paradigm based on a human rights-based value system, including inter-generational rights. However, as pointed out above, "sustainable development" is not a transformational paradigm, but rather a corrective one; even so, it still has enormous balancing potential. In spite of this limitation (being only corrective and not transformational), the systemic perspective of sustainable development is significantly useful in shining a critical light on the current model. Definitely, criticizing the current model or system is an important step in facing society's challenges with regard to proposing new alternatives.



## Part IV: Simulations

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### 1. Measuring Guatemala's Social Market Economic Performance– Data and Methodology

With the help of available data, we assess the extent to which a country complies with Social Market Economic principles. We focus on four indicators: (1) Subnational expenditures share (% GDP) from the World Bank's fiscal decentralization dataset, (2) the Heritage Foundation's overall index of economic freedom, (3) the Gini-coefficient from the United Nations University's World Income Inequality Dataset (WIID), and (4) the World Bank's average of all six "Worldwide Governance" indicators.

As for the fiscal decentralization measure, the basic hypothesis is that greater decentralized fiscal capacity makes government closer to the actual socioeconomic problems on the ground. Greater decentralized fiscal capacity therefore serves as a proxy for subsidiarity. Unfortunately, the available data for fiscal decentralization is already dated and the latest available observation for Guatemala is from 1993<sup>28</sup>. The data can be found at <http://goo.gl/uBRBqv>.

The Heritage Foundation defines economic freedom as "[...] the fundamental right of every human to control his or her own labor and property. In an economically free society, individuals are free to work, produce, consume, and invest in any way they please. In economically free societies, governments allow labor, capital, and goods to move freely, and refrain from coercion or constraint of liberty beyond the extent

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28 Of course, the fact that there is no data availability for Guatemala after 1993 could be used to question the validity of the 1993 observation as a benchmark for today's values. Yet, while this argument is theoretically legitimate, it seems rather unlikely that the value for Guatemala has dramatically improved over the last 23 years. For one, we ran a regression of all the countries with data from the 1990s up to the 2010s (sample size  $n=44$ ) with the "2010-2014 average fiscal decentralization score" as the dependent and the "1991-1995 average fiscal decentralization score" as the independent variable, and found a highly significant correlation between the two variables (the slope coefficient had a p-value of less than 0.1% and the R-squared was 80%). In other words, fiscal decentralization values from the early 1990s are, on average, a very good predictor for recent scores. Another reason to assume that Guatemala's current fiscal decentralization score is still in the close range of its 1993 value can be derived from experience with "statistical reporting tactics." If Guatemala had made substantial progress in fiscal decentralization since 1993, why would it be so difficult to report it? Most statisticians in the social sciences would probably agree that missing observations mask more often "bad numbers" than "good ones."

necessary to protect and maintain liberty itself.” (Heritage Foundation, 2015 Index of Economic Freedom, About the Index, <http://www.heritage.org/index/about>). For the purpose of this study, we use the Heritage Foundation’s 2015 Overall Score for Economic Freedom as a proxy for “Freedom in the Market.”

The Gini coefficient is a measure of inequality that ranges, theoretically, between zero and hundred. Higher scores indicate greater inequality. Obviously, a strong indicator for a country’s non-conformity with Social Market Economic principles is high income inequality combined with high degrees of economic freedom. Looking at measures of income inequality is therefore important. We use for our analysis the latest available Gini coefficients from the World Income Inequality Database (WIID), version 3.3 (<https://www.wider.unu.edu/download/wiid-v30b>), published by the United Nations University World Institute for Development Economics Research (UNU-WIDER). Guatemala’s latest observation is from 2010.

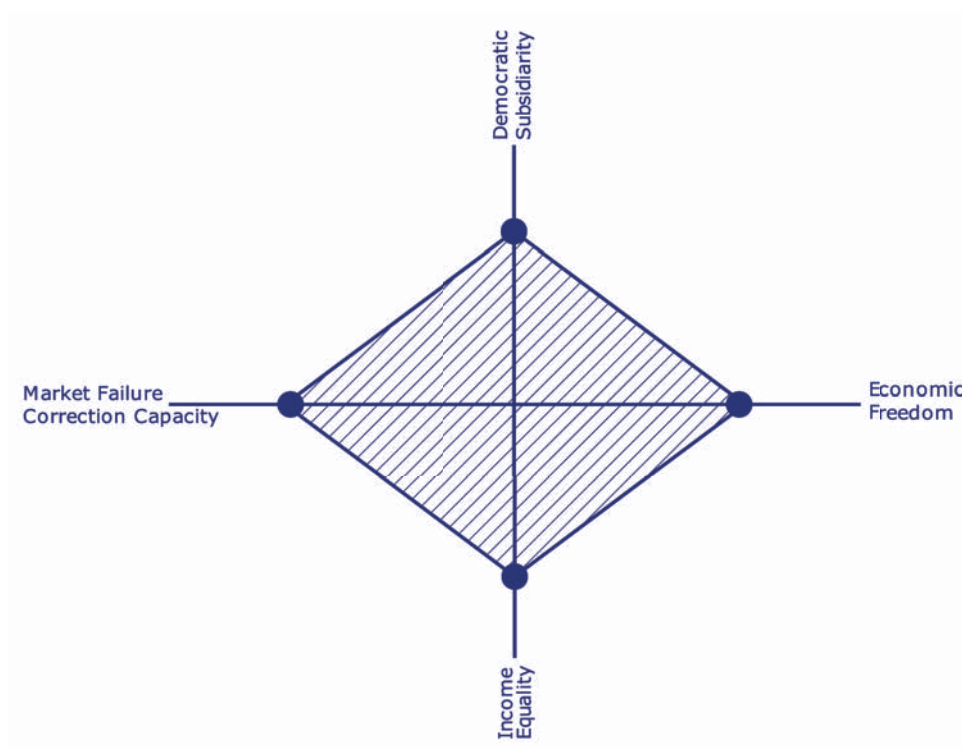
As for the government’s capacity to correct market failures and non-welcomed market dynamics, we employ the average of the World Bank’s six Worldwide Governance Indicators “Voice and Accountability,” “Political Stability,” “Government Effectiveness,” “Regulatory Quality,” “Rule of Law,” and “Control of Corruption.” While these indicators do not explicitly address a government’s commitments to limit market power, to build effective targeted social safety nets, and to counteract inequitable socioeconomic developments, they do address citizens’ representation in government, the quality of public services, government’s ability to formulate sound policies, and the isolation from special interest groups. We argue that this indicator therefore serves as a meaningful proxy for government’s ability to effectively recognize and correct market failures and non-welcomed market dynamics. The data can be retrieved from the World Bank’s Worldwide Governance Indicator’s website at <http://goo.gl/8SKQNr>. The latest available observation for Guatemala is the 2013-2014 observation.

Does Guatemala have a development deficit in any of the four Social Market Economic dimensions of democratic subsidiarity, freedom in the market, equitable socioeconomic development, and market failure correction capacity? In order to answer this question, we look at four scatter plots with the four Social Market Economic indicators displayed on the y-axis against GDP per capita always on the x-axis. We hypothesize that, on average, countries with higher GDP per capita have greater fiscal decentralization, less income inequality, higher levels of competitiveness,

and better governance. What matters for our analysis are Guatemala's data points in those scatter plots relative to the trend line, from which we can infer whether Guatemala has a relative development surplus or deficit.

In addition to the analysis of Guatemala's relative development status along the four Social Market Economic dimensions, we also want to estimate the development potential associated with greater investments into Social Market Economic policies. For this purpose, we first visualize a country's Social Market Economic performance in a radar plot and calculate from it a Social Market Economic Performance Indicator (SME-PI). The basic idea is illustrated in Figure 2.

**Figure 2: Visualizing Social Market Economic Performance**



Note. Marktanner (2015).

On the four axes, we display for a country  $i$  the corresponding four index scores (between zero and hundred), which are computed as follows:

$$\text{Democratic Subsidiarity}_i = \frac{\text{Subnational Expenditures}_i (\% \text{ of GDP}) - \text{Minimum Value in Dataset}}{\text{Maximum Value} - \text{Minimum Value in Dataset}} \times 100$$

$$\text{Economic Freedom}_i = \frac{\text{Overall Index of Economic Freedom}_i - \text{Minimum Value in Dataset}}{\text{Maximum Value} - \text{Minimum Value in Dataset}} \times 100$$

$$\text{Equitable Development}_i = 100 - \frac{\text{Gini Coefficient}_i - \text{Minimum Value in Dataset}}{\text{Maximum Value} - \text{Minimum Value in Dataset}} \times 100$$

$$\text{Market Failure Correction Capacity}_i = \frac{\text{Governance Score}_i - \text{Minimum Value in Dataset}}{\text{Maximum Value} - \text{Minimum Value in Dataset}} \times 100$$

The greater is the resulting area of the radar plot, the more a given country complies with Social Market Economic principles. The maximum possible area outlined by the radar plot is 20,000 and we calculate the SME-PI score simply as

$$\text{SME-PI} = \frac{\text{Country's Area}}{20,000} \times 100$$

By calculating the SME-PI<sup>29</sup> for all countries for which data is available, it is possible to rank Guatemala's SME-PI against other countries.

We also explore the relationship between the SME-PI and economic growth. The question we would like to ask is the following: How much more GDP per capita could Guatemala generate if it increased its SME-PI? For this purpose we argue that Social Market Economic principles predominantly affect an economy by increasing its total factor productivity (TFP). TFP is an empirically identifiable term that captures the extent to which an economy's production factors capital and labor harmonize productively. Greater values of TFP indicate a greater level of productive harmonization. Because a Social Market Economy is concerned with equal opportunity, market freedom, and good governance, we hypothesize that a stronger presence of Social Market Economic principles will increase the productive interaction of capital and labor.

29. The maximum area of one quadrant would be 5,000  $[(100 \times 100)/2]$  and by multiplying it by four (as there are four quadrants) a total of 20,000 units is obtained. This is the largest attainable area for this radar plot. The SME-PI is a range (%). 20,000 equals the 100% of the radar plot, therefore the formula is a cross-multiplication.

In order to be able to estimate the economic development dividend from implementing Social Market Economic reforms, we rely on data from the Penn World Tables, version 8.1 (Feenstra, Robert C., Robert Inklaar and Marcel P. Timmer (2015), "The Next Generation of the Penn World Table" forthcoming American Economic Review, available for download at [www.ggdnc.net/pwt](http://www.ggdnc.net/pwt)). The dataset contains information on countries' GDP, capital stock, labor force, and labor income share from which it is possible to estimate country  $i$ 's standard Cobb-Douglas production function of the kind

$$Y_i = TFP_i \times K_i^{1-\text{labor share}} \times L_i^{\text{labor share}}$$

where

$Y$  = GDP (constant US\$ 2005)

TFP=Total Factor Productivity

$K$  = Capital Stock

$L$  = Working population

By utilizing the relationship between SME-PI and total factor productivity, we then will be able to simulate the economic development dividend from Social Market Economic reforms.

For the purpose of this study, we were able to build a dataset with 72 observations. While the final composition of the dataset was exclusively determined by data availability, the regional composition of the observations, summarized in Table 6, suggests an acceptable level of regional stratification.

**Table 6: Regional Composition of Observations in Dataset**

Region	East Asia and the Pacific	Eastern Europe and Central Asia	Latin America and the Caribbean	Middle East and North Africa	North America	South Asia	Sub Saharan Africa	Western Europe	Total
Observations	8	15	13	5	2	1	10	18	72

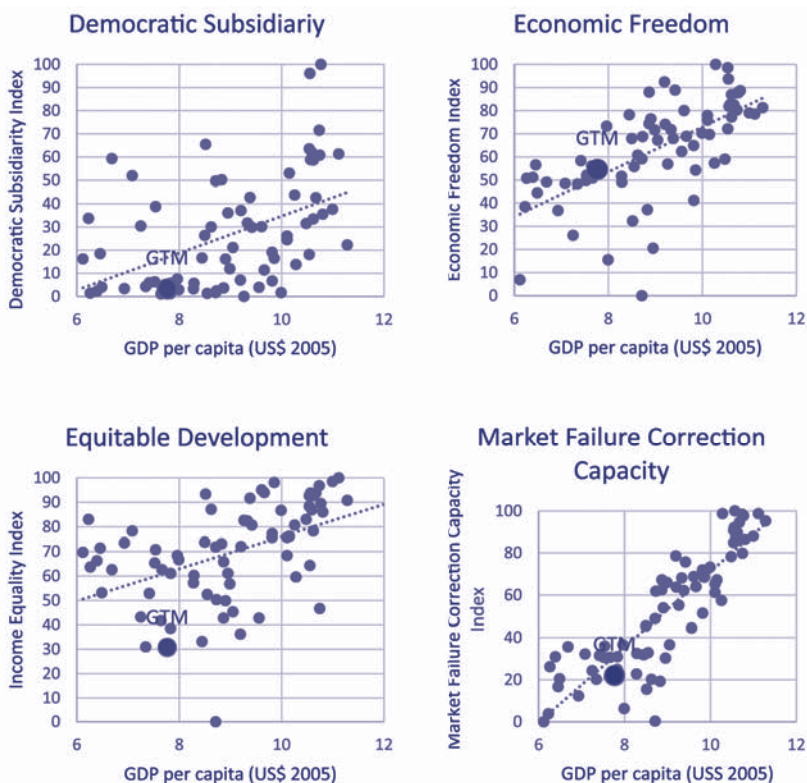
Note: Marktanner (2015).

## 2. Measuring Guatemala's Social Market Economic Performance– Results

### 2.1 Relative Social Market Economic Development Deficits and Surpluses

The below scatter plots show that Guatemala has, relative to its GDP per capita, development deficits in democratic subsidiarity, equitable socioeconomic development, and its capacity to correct market failures and non-welcomed market dynamics. It is though ranked slightly above the trend line in its economic freedom score. This strongly indicates that Guatemala has failed to use the freedom in the market as a vehicle for equitable social development.

**Figure 3: Scatter Plots**



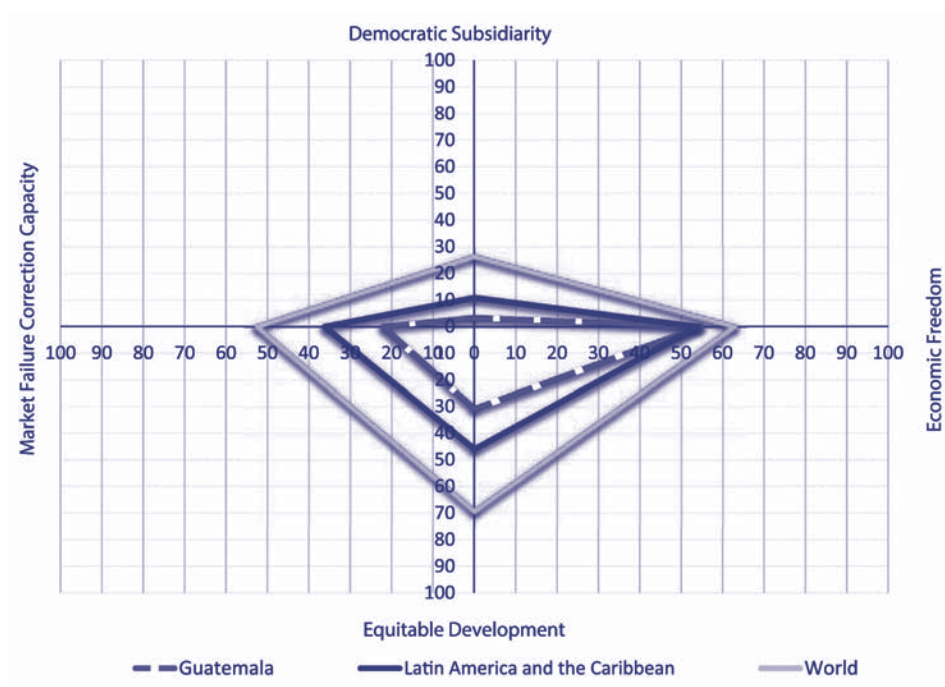
Note: Marktanner (2015).



## 2.2 Guatemala's Social Market Economic Performance Index Compared

Following the idea of Figure 2, Figure 4 shows three Social Market Economic performance radar plots. The radar plots are for Guatemala, the average of all Latin American countries, and the world average. The Latin American countries from which the average values were calculated are: Argentina, Bolivia, Chile, Colombia, Costa Rica, Dominican Republic, Guatemala, Honduras, Mexico, Paraguay, Trinidad and Tobago, Uruguay, and Venezuela.

**Figure 4: Social Market Economic Performance Radar Plots**



Note: Marktanner (2015).

When looking at the actual SME-PI scores, Guatemala ranks third from the bottom among all Latin American countries. Only Honduras (second worst) and Venezuela (worst) have lower SME-PI scores. Table 7 summarizes the SME-PI scores for all 72 countries in our dataset.



**Table 7: Social Market Economic Performance Indicators**

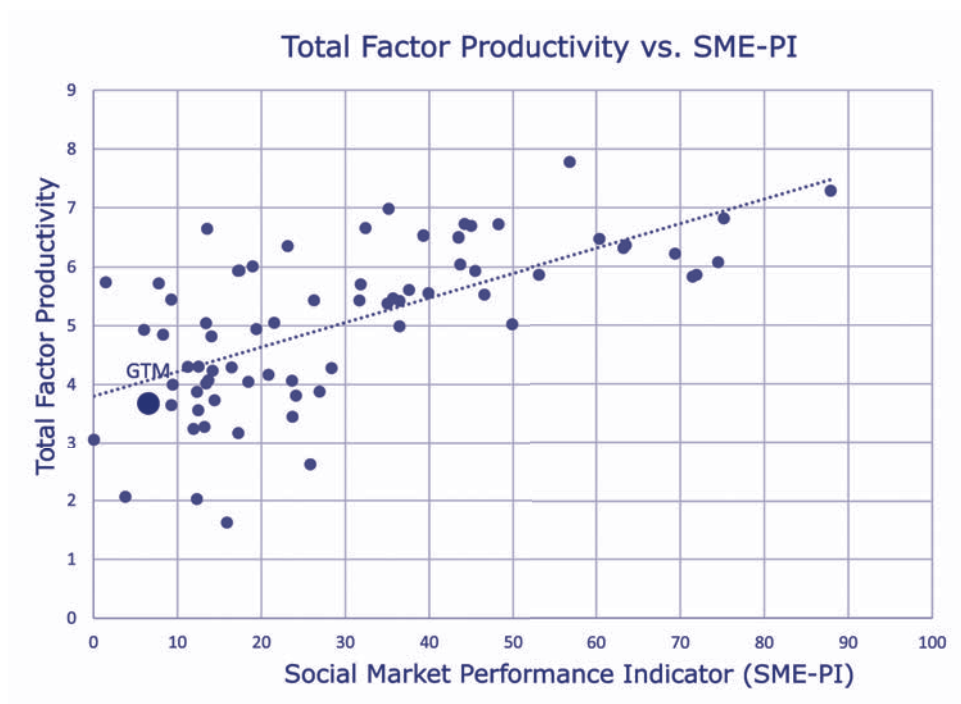
Country Name	Region	SME-PI	Country Name	Region	SME-PI
Argentina	Latin America and the Caribbean	12.3	Kazakhstan	Eastern Europe and Central Asia	23.7
Australia	East Asia and the Pacific	71.9	Kenya	Sub Saharan Africa	9.3
Austria	Western Europe	63.3	Korea, Rep.	East Asia and the Pacific	36.5
Belarus	Eastern Europe and Central Asia	19.0	Kyrgyz Republic	Eastern Europe and Central Asia	16.5
Belgium	Western Europe	43.5	Latvia	Eastern Europe and Central Asia	37.6
Benin	Sub Saharan Africa	14.1	Luxembourg	Western Europe	49.9
Bolivia	Latin America and the Caribbean	9.3	Malaysia	East Asia and the Pacific	21.5
Botswana	Sub Saharan Africa	15.9	Mauritius	Sub Saharan Africa	27.0
Bulgaria	Eastern Europe and Central Asia	28.4	Mexico	Latin America and the Caribbean	17.3
Burkina Faso	Sub Saharan Africa	12.5	Moldova	Eastern Europe and Central Asia	26.3
Cameroun	Sub Saharan Africa	9.4	Mongolia	East Asia and the Pacific	24.1
Canada	North America	74.5	Morocco	MIDDLE EAST AND NORTH AFRICA	14.2
Chile	Latin America and the Caribbean	18.5	Netherlands	Western Europe	60.4
Colombia	Latin America and the Caribbean	13.7	New Zealand	East Asia and the Pacific	36.5
Costa Rica	Latin America and the Caribbean	17.2	Norway	Western Europe	71.5
Croatia	Eastern Europe and Central Asia	23.1	Paraguay	Latin America and the Caribbean	13.2
Cyprus	Western Europe	31.7	Philippines	East Asia and the Pacific	8.3
Czech Republic	Eastern Europe and Central Asia	46.6	Poland	Eastern Europe and Central Asia	39.9
Denmark	Western Europe	87.9	Portugal	Western Europe	32.4
Dominican Republic	Latin America and the Caribbean	11.9	Russian Federation	Eastern Europe and Central Asia	17.4
Estonia	Eastern Europe and Central Asia	45.5	Senegal	Sub Saharan Africa	25.8
Fiji	East Asia and the Pacific	11.2	Slovak Republic	Eastern Europe and Central Asia	35.0
Finland	Western Europe	69.4	Slovenia	Eastern Europe and Central Asia	35.2
France	Western Europe	39.3	South Africa	Sub Saharan Africa	13.4
Germany	Western Europe	63.5	Spain	Western Europe	44.2
Greece	Western Europe	19.4	Sri Lanka	SA	13.6
Guatemala	Latin America and the Caribbean	6.5	Swaziland	Sub Saharan Africa	7.8
Honduras	Latin America and the Caribbean	6.0	Sweden	Western Europe	75.2
Hungary	Eastern Europe and Central Asia	43.7	Tajikistan	Eastern Europe and Central Asia	12.3
Iceland	Western Europe	56.8	Trinidad and Tobago	Latin America and the Caribbean	12.5
Indonesia	East Asia and the Pacific	14.4	Tunisia	MIDDLE EAST AND NORTH AFRICA	13.4
Iran, Islamic Rep.	MIDDLE EAST AND NORTH AFRICA	3.8	United Kingdom	Western Europe	48.3
Ireland	Western Europe	53.2	United States	North America	45.0
Israel	MIDDLE EAST AND NORTH AFRICA	31.8	Uruguay	Latin America and the Caribbean	23.7
Italy	Western Europe	35.7	Venezuela, RB	Latin America and the Caribbean	0.1
Jordan	MIDDLE EAST AND NORTH AFRICA	20.9	Zimbabwe	Sub Saharan Africa	1.5

Note: Marktanner (2015).

## 2.3 Total Factor Productivity and Social Market Economic Environment

Do countries with a better Social Market Economic performance environment also have a more productive economy? In other words, do public policies to improve democratic subsidiarity, economic freedom, equal access to economic opportunities, and market failure correction capacities make a country more productive? To explore this question, we first look at a scatter plot of total factor productivity vs. the Social Market Economy Performance Indicator (Figure 5).

**Figure 5: Total Factor Productivity vs. Social Market Economy Performance Indicator**



Note: Marktanner (2015).

The scatter plot strongly suggests that countries with a strong Social Market Economic performance framework also have higher total factor productivity. Regardless of this general relationship, the scatter plot also illustrates clearly that Guatemala's economy is not only embedded in a poor Social Market Economic environment, but is also characterized by a very low level of total factor productivity.

In order to test the robustness of the relationship between total factor productivity and Social Market Economic performance, we also run a regression of total factor productivity against SME-PI and per capita income and regional fixed effects as additional control factors, specifically

$$TFP(\ln)_i = Const + \beta_1 SMEPI_i + \beta_2 GDP/capita(\ln)_i + \sum_j \beta_j Regional\ Dummy_i + u_i$$

The reason for this specification is as follows. Total factor productivity is obviously not only a function of Social Market Economic performance but also the general development level of an economy, which we proxy by the variable GDP per capita in constant 2005 USD (GDP/capita). The data was retrieved from the World Bank Development Indicator Database. We also control for regional fixed effects. Regional fixed effects can be thought of as control variables for "everything else that is not captured by SME-PI or GDP/capita." We run the regression against the advanced developing areas of North America and Western Europe. In running the regression, we take the natural log(ln) of TFP and GDP/capita to reduce the loss of estimation efficiency due to the strong right-skewedness of these two variables. Table 8 summarizes the regression results.

**Table 8: Regression Results of Total Factor Productivity against SME-PI**

<b>DV =PTF (ln)</b>	<b>Model I</b>	<b>Model II</b>	<b>Model III</b>
Constant	3.800*** (0.214)	2.471** (1.061)	3.039** (1.58)
SME-PI	0.042*** (0.006)	0.032*** (0.010)	0.017 (0.011)
GDP/capita (ln)		0.180 (0.141)	0.223 (0.157)
East Asia and the Pacific			-0.931* (0.477)
Eastern Europe and Central Asia			-0.218 (0.420)
Latin America and the Caribbean			-1.120** (0.509)
Middle East and North Africa			-1.165* (0.593)
South Asia			1.667 (1.075)
Sub Saharan Africa			-0.580 (0.580)
n	72	72	72
Adj. R2	0.41	0.41	0.48
F-Stat	49.97	26.03	9.23

Note: Marktanner (2015).

Standard errors in parentheses, \*=significant at 10%, \*\*=significant at 5%,  
\*\*\*=significant at 1%

Table 8 indicates that the Social Market Economy performance indicator is a robust correlate of total factor productivity. The expected positive sign prevails across all three model specifications. The SME-PI variable is moreover highly significant in model specifications I and II, and while it loses statistical significance at the 10% level in model III, the p-value (not shown in Table 3) is still 0.13. Yet, the loss of statistical significance must not be attributed to economic non-significance, but to the statistical effect of multicollinearity. In fact, the variables SME-PI and GDP/capita are highly correlated with a Pearson correlation coefficient of 0.79.

## 2.4 Estimating Guatemala's Economic Development Dividend from Social Market Economic Reforms

According to the radar plot of Figure 4, Guatemala performs worse than the average of all Latin American and Caribbean countries, and worse than the world average (as determined by our dataset consisting of 72 countries). Table 9 summarizes the relevant scores.

**Table 9: Guatemala's Social Market Economic Performance Compared to Latin America and the World**

	Sub National Expenditures Share (%GDP) (Democratic Subsidiarity)		Heritage's Economic Freedom Index (Market Freedom)		Gini-Coefficient (Equitable Development)		Good Governance (Market Failure Correction Capacity)		SME-PI
	Raw Score	Index	Raw Score	Index	Raw Score	Index	Raw Score	Index	Index
Guatemala	1.03	3.3	60.43	54.7	55.1	30.8	-0.62	22.1	6.55
Latin America and the Caribbean	3.40	10.9	60.13	54	48.1	45.9	-0.17	36.2	12.81
World	9.32	26.4	65.29	62.9	34.8	69.3	0.46	52.6	27.63

From the regression results of Table 8, model III, we can conclude that for every percentage point increase in Guatemala's SME-PI score, the country's total factor productivity increases by 1.7%. This means that if Guatemala could close its Social Market Economic performance gap to Latin America's average score of roughly six percentage points, Guatemala's GDP would be predicted to be 10% higher. In the case of closing the SME-PI gap of 21 percentage points to the world average, Guatemala's estimated GDP would be almost 36 percent higher.



## Parte V:

### **Key informant interview results**

von Hoegen (2015) has explained how the principles of Social and Ecological Market Economy have been incorporated into Guatemalan legislation. Although these principles are present, little is known about the awareness of their application in practice. To examine this point, a number of key stakeholders were consulted using what is known as the Delphi method. This method allows information to be gathered from key informants who are hard to get together for a focus group or group interview and with whom it would be difficult to set up individual appointments.

The procedure consists of sending key informants an initial questionnaire with closed questions and a space for comments. Then, they are sent the results together with the comments for review. Together with the results from the first round, they are also sent another questionnaire similar to the first. On this questionnaire, they can make new comments, expound, or respond to other participants' comments. In this manner, it is possible to recover some of the interaction they would have had in a focus group setting. Although numerical data is obtained, since this is not a representative sample it is not presented as percentages which could suggest a possible presentation to the public.

**Table 10. Participants in both rounds by sector**

Sector	Number of experts consulted	Respondents on Round 1	Respondents on round 2
Government	10	2	2
Civil society	9	1	1
Academia	8	2	2
Think tanks	7	3	3
Private sector	2	2	2
TOTAL	36	10	10

Note: ASIES staff results

The first round examined three aspects, each with a variable number of questions or reactions. The aspects and reactions are detailed in Table 10. The interviewees were asked to score each statement in the reaction box from 1 (strongly disagree) to 5 (strongly agree).

**Tabla 11. Aspects and responses used in the expert survey**

Aspect	Reaction
Necessary conditions and State constitutive principles	<p>Rulers are elected through a free and fair election process.</p> <p>Democratically elected rulers have the effective power to rule.</p> <p>Sub-national governments have total control over sub-national affairs.</p> <p>Politicians are independent from groups with special interests.</p> <p>The powers are separate and independent of each other.</p> <p>The State has created an adequate legal framework for the economy and maintains a healthy level of competition.</p>
Market failure corrective principles	<p>The government effectively combats companies with market power (dissolving monopolies or at least controlling their market behavior)</p> <p>The government effectively combats environmental problems</p> <p>The government effectively combats inequitable social development</p> <p>The government effectively promotes worker protection measures, especially for women and children</p>
Market intervention principles	<p>The government does not act as an economic player</p> <p>The public sector produces the goods and services that the private sector does not</p> <p>In times of economic crisis, the government trusts in the market's self-healing powers</p> <p>The government effectively leads social assistance programs to support vulnerable sectors of society</p>

Note: ASIES staff results

In the second round, the interviewees used the results and comments from the first round to identify which of these characteristics are best met or closest to being met. They also determined which characteristics are least met or unmet. This was accomplished by asking the interviewees to identify the two best and two worst of each category. Then, the Maxdiff procedure was used to identify the best and worst in each group. It is important to point out that many of the interviewees found the procedure restrictive and expressed their displeasure. One preferred not to respond and another affirmed that, "the questions are almost leading and appear biased".

Under the first aspect, State constitutive principles, the following prioritization was established, from closest to being met to furthest from being met.

**Table 12. Prioritization of necessary conditions and State constitutive principles**

Closest to being met	
	<ul style="list-style-type: none"> <li>• Rulers are elected through free and fair election processes.</li> <li>• The State has created an adequate legal framework for the economy and maintains a healthy level of competition.</li> <li>• Sub-national governments have total control over sub-national affairs.</li> <li>• Democratically elected rulers have the effective power to rule.</li> <li>• The powers are separate and independent from each other.</li> <li>• Politicians are independent from groups with special interests.</li> </ul>
Furthest from being met	

Note: ASIES staff results

This case illustrates one of the technique's strengths. In the first exercise, all the responses, with the exception of the first two, scored extremely low on the Likert scale. This showed that none of the conditions were viewed as fully met. In this case, prioritization established an order to show which of the insufficiencies was most perceived.



With regard to this first group, although many agreed that, formally, elections are free and fair, it was necessary to clarify that this is just a façade. One of the comments captured the opinion of the majority:

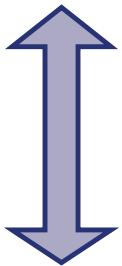
*"Elections are effectively free on the part of the State, but are not free on the part of the constituency that sells it vote to the highest bidder, is not properly informed, and oftentimes votes for the wrong reasons."*

*In many cases, disapprobation of the election system showed a clear link to the problem of interest groups. Many interviewees affirmed that democratically elected rulers do not have effective power.*

*"With regard to the last few administrations, we have seen that they respond to the interests of a small group of people who fund their campaigns".*

The second aspect related to correcting market failures scored very low in the first round of questionnaires. With the exception of worker protection measures, all the responses scored "disagree" or lower. The final prioritization was as follows:

**Table 13. Prioritization of market failure corrective principles**

Closest to being met	
	<ul style="list-style-type: none"> <li>• The government effectively promotes worker protection measures, especially for women and children</li> <li>• The government effectively combats inequitable social development</li> <li>• The government effectively combats environmental problems</li> <li>• The government effectively combats companies with market power (dissolving monopolies or at least controlling their market behavior)</li> </ul>
Furthest from being met	

Note: ASIES staff results

This case illustrates one of the technique's strengths. In the first exercise, all the responses, with the exception of the first two, scored extremely low on the Likert scale. This showed that none of the conditions were viewed as fully met. In this case, prioritization established an order to show which of the insufficiencies was most perceived.

It should be pointed out that, with the exception of the first aspect, all others were more often scored far from being met rather than close to being met. Many interviewees affirmed that these deficiencies stem from the weakness of the State. Worker protection, although scoring higher, was still insufficient in the opinion of many experts, as expressed in the following comment:

*"With regard to the protection of workers, women, and children, the term protection is too broad. The Social Security Institute is ineffective in this regard. The State protects and gives much power to worker unions, if that is what the terms refers to; there is no freedom of contract, if that lack of contract can be viewed as protecting the worker from the company. The law forbids the employment of children, but the rural economic structure takes it for granted. There are many clandestine forms of child labor."*

*Environmental topics were viewed as overlooked and affected by a short-term vision as well as issues with cronyism as mentioned previously. As one expert said,*

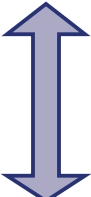
*"With regard to environmental issues, there are no sustainable policies because those who contaminate or exploit natural resources are the same companies that finance political parties."*

In the last aspect, combating monopolies, the need for a Competition Law is brought up. Lastly, not all the experts shared the premise that the State should correct market failures. One opinion reads,

*"In this regard, I feel that the government and those that defend social causes are caught up with the Social Justice part of things and have overlooked Market Economy."*

In the category on market intervention principles, most affirmations scored "disagree", with the exception of "the government does not act as an economic player", which several experts agreed with.

**Tabla 14. Prioritization of market intervention principles**

Closest to being met	
	<ul style="list-style-type: none"> <li>• The government does not act as an economic player</li> <li>• In times of economic crisis, the government trusts in the market's self-healing powers</li> <li>• The government effectively directs social assistance programs to support vulnerable sectors of society</li> <li>• The public sector produces goods or services that the private sector does not</li> </ul>
	Furthest from being met

Note: ASIES staff results

In this case, comments were scarce and more given to criticism. The State's participation as an economic player is adverse, as illustrated by the following comment:

*"The government does act like an economic player. It is one of the largest employers, I don't know if it is in fact the largest; it implements infrastructure projects that could be done by private companies. Almost all goods and services provided by the State could be provided by the private sector. State-specific services, justice, security, legislation, and government administration are the only actual services of the State. Health and education could be mixed State and private sector services."*

Social assistance programs were viewed as lacking in direction, as expressed by this opinion:

*"The most vulnerable sectors are youth, indigenous people, women, and senior citizens, There are no specific programs to care for these sectors."*

Once again, this weakness is chalked up to cronyism mentioned at the beginning of the survey.

*"Social assistance programs for vulnerable sectors are in reality just patronage programs for political propaganda."*



## Findings and recommendations

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### Findings

Why is income inequality so persistent in Guatemala? The discussion of historical and contemporary development in Guatemala has shown that income inequality is the result of the interaction of many factors. These factors are: (1) The country's colonial history has paved the way for a divide between the descendants of the European settlers and the indigenous people as well as for a divide between urban and rural development. (2) Guatemala's long civil war, which was mostly fought in rural areas, had stalled rural economic development for three decades and was thus a major contributor to the rural-urban gap. (3) Closing the gap between rural and urban development is substantially undermined by a strong focus on natural resource extracting economic activities in rural areas and also the continuity of the production model characterized by the predominance of agricultural labor, which leads to a continuous decline of rural livelihood bases. (4) Climate change and resulting natural hazards also tend to affect rural areas more than urban ones. (5) Most importantly, while Guatemalan politics regularly incorporates the issue of inequitable social development into its political rhetoric, the country has not yet implemented effective policy response mechanisms to meaningfully address the problem of persistent income inequality in political and socioeconomic reality.

Before 1986, Guatemala suffered from political and economic problems in which power was exercised by military governments; this led to the implementation of various economic policy measures, one of which was to slow down excessive price increases by imposing price caps. Yet, far from reaching the expected objective of regulating the offer of certain commodities, this measure led to forced price stagnation, shortages, and discouragement of the business sector, which no longer had any incentives to continue producing. However, later, other measures were implemented, often with reference to an alleged SME framework, which liberalized prices and allowed other products to access the market, which was complemented with the liberalization of the prices of the main macroeconomic variables, thereby incentivizing competition.

Guatemala dealt with the global financial crisis (2008) properly and wisely by implementing counter-cyclical measures (fiscal and monetary). This prevented the economy from falling into recession as it did in the majority of Latin American countries. Although these measures reached their objective, no economic expansion measures were implemented in the years following the crisis that could translate into benefits for the Guatemalan economy, especially in improving significant social indicators.

Although formally there are many aspects of SME present in Guatemalan legislation, in practice, they are not consistently enforced. In general, it is understood that cronyism is the main reason preventing SME policies from being properly implemented and is also hindering adequate citizen participation. Cronyism also reduces the capacity to address environmental issues and the effectiveness of social programs.

In order to achieve the equal distribution of resources, a fiscal system in accordance with development planning is needed, but Guatemala's tax system is a regressive one. A comprehensive fiscal reform should be implemented to strengthen the State financially and to take care, within the framework of transparency and quality of the public management, of the principal problems affecting the population. Efforts have been made in order to combat poverty by implementing different social programs; nevertheless the results have not been the intended. It is necessary that the authorities put a greater effort to ensure that this topic be a main point on their administration's agenda regarding the technical criteria in its implementation and eliminating the mischievous intentions which has characterized them.

Formally, democracy is working but is obscured by cronyism and meager opportunities for citizen public participation. In terms of democratic governance, citizens must engage more in electoral matters and consolidate their participation in political activities. People trust more in local governments than in the three branches of the State and in political parties. In Guatemala, certain social groups have very little political representation, such as with indigenous people, who are a minority in Congress.

The right to work is protected by the Constitution as well as a labor code, the contributive social security, specific laws, and various ILO conventions ratified by Guatemala. Thus, labor affairs have sufficient legal framework to bolster work opportunities; however, public policies have not managed to make the economic system provide enough formal jobs to absorb the

waves of new graduates, nor have they encouraged businesses, particularly small and micro enterprises, to increase job offers.

Productive activities, specially mining, have not been accompanied by timely efforts to prevent and mitigate environmental crises resulting from the reckless use of natural resources. The environment's vulnerability is due to exhaustion, degradation, and contamination provoked by the activities of society in general; therefore climate change problems could be prevented by investing financial resources and drafting a development model that includes environmental issues. The environmental problem is being addressed using a short-term approach. Consequentially, solutions to environmental problems are oftentimes affected by groups with hidden interests.

In order to move towards a Social Market Economy, Guatemala is in need of finding a way to balance the freedom in the market with equitable social development. A social market economy is committed to creating a competitive economic environment, whereas competition does not only mean to have free entry and exit to open markets. Competition also means to empower disenfranchised segments of society to gain access to these markets through public investments in market access capabilities such as education, health care, and finance. As opposed to laissez-faire liberalism, which became a popular development strategy in the 1980s and 1990s under the buzzword of the Washington Consensus, Social Market Economics acknowledges that equal opportunities are not a natural state of the free market, but a natural right. This natural right needs to be provided by the government through political arrangements and an effective public policy.

For a country to balance the freedom in the market with equitable social development, Social Market Economists emphasize (1) a need for democratic subsidiarity as the major state-constituting principle, (2) economic freedom as the major driver of equitable social development through both open and competitive markets and equal access to economic opportunities, and (3) sufficient public policy capacity to address market failures and inequitable social development through effective competition, social, and environmental policies. In this report, we proxied these three areas by measures of (1) fiscal decentralization as a proxy for democratic subsidiarity, (2) the Heritage Foundation's Index of Economic Freedom as a proxy for freedom in the market, and (3) the average score of the World Bank's good governance indicators as a proxy for public policy capacity to address market failures and inequitable social development.

This analysis has shown that while Guatemala scores reasonably well on the freedom in the market dimension, it faces huge deficits in the areas of democratic subsidiarity and market failure correction capacities. In other words, while Guatemala enjoys considerable economic freedom, economic freedom is not yet a driver of equitable social development.

This report has also blended the three policy areas of democratic subsidiary, economic freedom, and market failure correction capacity with actual income inequality to construct a Social Market Economic Performance Index (SME-PI). Guatemala's resulting score puts it well below the average of all Latin American countries and the world as a whole. The area with the greatest need for reforms from this bird's eye view's perspective is clearly the lack of fiscal decentralization as measured by subnational governmental expenditures as a percentage of GDP. Compared to other countries and given Guatemala's high level of income inequality, Guatemala simply spends too little on social mobility and concentrates too much of all government spending in the central budget, instead of directing the spending authority to the subnational level. This conclusion is well in line with the observation highlighted in this report that citizens trust local governments much more than the central government, and that they also feel much better served by local governments. It is also essential to achieve the increase and the improvement of the measures focus in transparency and the supervision of public funds used by local governments, in order to make use of them more efficiently and transparently and reduce corruption.

Democratic subsidiarity means to bring problem-solving agency closer to where the actual problems are. While democratic subsidiarity not only promises greater effectiveness in empowering people from a theoretical perspective, this report has also shown that this hypothesis is indeed supported by real world data. Countries with a higher SME-PI score enjoy a greater total factor productivity.

## **Recommendations**

In order for social welfare public policies to be enforced, public administration must be strengthened, particularly the institutional framework. Many of the issues related to social structure are due to a lack of availability to and ineffective distribution of resources, together with inefficient execution and planning; therefore, public administration must improve its program management skills.



After the dramatic political events that took place starting April 16th, 2015 up through the second round of presidential elections, the people cried out for laws<sup>30</sup> enabling State reform, bounded to the judiciary and fiscal systems (juridical and fiscal careers), especially the Electoral and Political Party Law, Civil Service Law, and the State Procurement and Contracts Law. The Competition Law –currently as an Initiative of law in the legislative body– should be added to this group in order to strengthen the economy in terms of providing opportunities for the entire business sector, regardless of size. Furthermore, efforts aimed at increasing the country's competitiveness should continue in order to increase national and foreign investment, and subsequently, sources of employment. All this, within a framework of macroeconomic stability which has prevailed in the country for several years, is the basis for economic activity favoring sustained growth rates above 4%, as seen during the past two years, in order to reduce social deficits and improve the standard of living for the public in general.

At the same time, it is necessary to promote laws creating incentives to shrink informal economy by strengthening production and generating job opportunities with decent working conditions, salaries, benefits, and social security for the troops of young people entering the labor market every year. It is also necessary to enact laws and implement actions aimed at strengthening the auditing capacities of government agencies, such as the Public Ministry (MP), Ministry of Labor, and labor courts to ensure strict compliance with labor laws.

In support of policies ensuring macroeconomic stability based on explicit inflation targets and floating exchange rates, in order to prevent product shortages that could alter commodity prices, it is necessary to implement economic development and production diversification policies in a framework of competitiveness to strengthen supply and prevent the interference of monopolies.

For the successful implementation of SEME proposals, it is necessary for the State of Guatemala to have at its disposal better quality and more complete information to be able to perform impact studies and identify opportunities as well as possible threats, factors needed in good decision-making.

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30. 1 On the one hand, the National Congress is currently reforming the Civil Service Law (Decree Number 1748; reforms on the Initiative Number 4984) and did receive the Project of the Competition Law (Initiative Number 5074). On the other hand, the Congress approved the reforms on the State Procurement and Contracts Law (Decree Number 57-92), by the Decree 9-2015 on December the 15th 2015 and also the modifications on the Electoral and Political Law (Decree Number 1-85), by the Decree 26-2016 on May the 25th.



The laws focusing on environmental protection do not respond to a political will to promote a clean economy which allows man to coexist with the ecosystem. The country's position should be based on a mitigation and environmental protection vision, through sustainable development.

These detailed policy recommendations, of course, will not be realized without a strong political commitment to Social Market Economic principles in political practice. In political debate, the term Social Market Economy is still subject to a lot of controversy. Politicians like to use the term for its political appeal. Using the term Social Market Economy makes policy makers appear to be considerate of the fallacies of the free market without jeopardizing people's desire for freedom. However, there is good reason to assume that Social Market Economic political rhetoric is often not much more than a façade, behind which there is not much actual knowledge about what the founding fathers of a Social Market Economy truly wanted and want politicians and civil society to understand. It is hoped that this report will help public policy and civil society to engage in constructive political dialog to the benefit of Guatemala and its citizens.

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**Appendix Table 1: GDP per Capita (US\$ 2005) and Subnational Expenditure Shares (%GDP)**

Country Name	Country Code	GDP per Capita (\$2005)	Subnational Expenditures Shares (%GDP)
Argentina	ARG	7,737.72	11.27
Australia	AUS	37,828.25	19.83
Austria	AUT	41,077.36	18.33
Bielorrusia	BLR	4,998.28	20.44
Belgium	BEL	37,857.25	5.67
Benín	BEN	598.22	0.72
Bolivia	BOL	1,408.98	9.51
Botsuana	BWA	7,095.69	1.17
Bulgaria	BGR	4,915.85	8.24
Burkina Faso	BFA	525.7	0.46
Cameroon	CMR	1,023.63	1.07
Canadá	CAN	38,293.28	30.00
Chile	CHL	9,853.53	2.21
Colombia	COL	4,657.75	5.20
Costa Rica	CRI	6,188.14	0.78
Croatia	HRV	10,561.27	0.01
Cyprus	CYP	21,852.09	0.53
Czech Republik	CZE	14,944.52	9.42
Denmark	DNK	47,546.91	31.21
Dominican Republic	DOM	5,161.12	0.42
Estonia	EST	12,348.08	9.34
Fiji	FJI	3,946.74	1.03
Finland	FIN	38,837.11	18.37
France	FRA	35,666.6	9.85
Germany	DEU	39,717.7	19.36
Greece	GRC	18,377.24	2.10
Guatemala	GTM	2,356.84	1.03
Honduras	HND	1,551.22	1.35
Hungary	HUN	11,888.11	13.34
Iceland	ISL	59,692.87	11.76
Indonesia	IDN	1,853.81	2.00
Irán, Islamic Rep.	IRN	2,961.62	0.92
Ireland	IRL	49,360.56	11.10
Israel	ISR	24,540.58	7.66
Italy	ITA	28,484.35	13.68
Jordan	JOR	2,878.22	2.36

Country Name	Country Code	GDP per Capita (\$2005)	Subnational Expenditures Shares (%GDP)
Kazakhstan	KAZ	5,575.55	9.39
Kenya	KEN	658.71	1.27
Rep. Korea	KOR	24,565.56	8.16
Kyrgyz Republic	KGZ	637.26	5.77
Latvia	LVA	9,973.57	11.59
Luxembourg	LUX	79,511.21	6.95
Malaysia	MYS	7,373.99	5.06
Mauritius	MUS	7,116.59	1.15
México	MEX	8,517.04	6.61
Moldova	MDA	1,190.7	16.22
Mongolia	MNG	1,882.38	12.11
Marocco	MAR	2,527.18	1.81
Netherlands	NLD	43,140.91	13.31
New Zeland	NZL	29,201.12	4.32
Norway	NOR	67,245.6	19.14
Paraguay	PRY	2,089.75	0.35
Philippines	PHL	1,665.29	1.87
Poland	POL	11,304.62	9.91
Portugal	PRT	18,300.44	5.96
Russian Federation	RUS	6,843.91	15.68
Senegal	SEN	802.35	18.51
Eslovak, Republik	SVK	15,726.85	3.58
Slovenia	SVN	19,110.56	5.15
South Africa	ZAF	6,086.45	15.51
Spain	ESP	25,617.55	16.56
Sri Lanka	LKA	2,135.66	1.24
Swaziland	SWZ	2,519.47	0.39
Sweden	SWE	46,061.43	22.33
Tajikistán	TJK	507.39	10.54
Trinidad and Tobago	TTO	14,200.31	1.25
Tunisia	TUN	3,979.43	1.79
United Kingdom	GBR	40,967.7	10.45
United States	USA	46,405.26	18.98
Uruguay	URY	8,016.68	3.75
Venezuela, RB	VEN	6,088.08	0.52
Zimbabwe	ZWE	455.1	5.07

Note. Author's calculations based on the data described previously.

**Appendix Table 2: Economic Freedom, Gini, and Governance**

Country Name	Country Code	Economic Freedom	Gini	Governance
Argentina	ARG	44.14	41.00	-0.36
Australia	AUS	81.39	28.30	1.56
Austria	AUT	71.19	26.30	1.53
Belarus	BLR	49.77	26.00	-0.83
Belgium	BEL	68.78	26.30	1.37
Benin	BEN	58.78	38.60	-0.34
Bolivia	BOL	46.82	49.30	-0.55
Botswana	BWA	69.82	49.50	0.66
Bulgaria	BGR	66.77	35.10	0.12
Burkina Faso	BFA	58.58	39.80	-0.49
Cameroon	CMR	51.91	35.20	-0.93
Canada	CAN	79.06	39.50	1.60
Chile	CHL	78.46	52.60	1.17
Colombia	COL	71.69	54.00	-0.31
Costa Rica	CRI	67.16	46.00	0.64
Croatia	HRV	61.51	31.00	0.43
Cyprus	CYP	67.90	29.10	1.00
Czech Republic	CZE	72.54	25.20	0.86
Denmark	DNK	76.26	27.80	1.78
Dominican Republic	DOM	61.00	45.00	-0.28
Estonia	EST	76.76	31.90	1.08
Fiji	FJI	59.01	42.80	-0.60
Finland	FIN	73.43	25.80	1.85
France	FRA	62.52	30.80	1.16
Germany	DEU	73.78	29.00	1.47
Greece	GRC	53.99	33.50	0.31
Guatemala	GTM	60.43	55.10	-0.62
Honduras	HND	57.38	55.00	-0.68
Hungary	HUN	66.80	26.80	0.65
Iceland	ISL	72.04	23.60	1.47
Indonesia	IDN	58.13	39.00	-0.35
Iran, Islamic Rep.	IRN	41.76	38.40	-1.12
Ireland	IRL	76.64	29.40	1.42
Israel	ISR	70.55	37.60	0.62
Italy	ITA	61.70	31.90	0.50
Jordan	JOR	69.32	37.60	-0.16



Country Name	Country Code	Economic Freedom	Gini	Governance
Kazakhstan	KAZ	63.35	28.90	-0.68
Kenya	KEN	55.56	44.70	-0.67
Korea, Rep.	KOR	71.54	34.20	0.75
Kyrgyz Republic	KGZ	61.35	36.20	-0.79
Latvia	LVA	69.70	35.90	0.70
Luxembourg	LUX	73.16	27.20	1.70
Malaysia	MYS	70.84	46.20	0.39
Mauritius	MUS	76.35	38.80	0.81
Mexico	MEX	66.43	48.30	-0.16
Moldova	MDA	57.51	33.00	-0.30
Mongolia	MNG	59.24	36.50	-0.18
Morocco	MAR	60.12	41.00	-0.34
Netherlands	NLD	73.70	25.80	1.68
New Zealand	NZL	82.07	41.70	1.81
Norway	NOR	71.82	22.90	1.81
Paraguay	PRY	61.12	50.00	-0.64
Philippines	PHL	62.20	44.80	-0.32
Poland	POL	68.61	31.10	0.84
Portugal	PRT	65.32	34.20	0.96
Russian Federation	RUS	52.09	35.40	-0.71
Senegal	SEN	57.81	40.30	-0.19
Slovak Republic	SVK	67.24	25.70	0.71
Slovenia	SVN	60.28	23.80	0.85
South Africa	ZAF	62.59	69.40	0.23
Spain	ESP	67.63	34.00	0.81
Sri Lanka	LKA	58.63	40.30	-0.35
Swaziland	SWZ	59.86	51.50	-0.53
Sweden	SWE	72.66	24.40	1.80
Tajikistan	TJK	52.70	30.80	-1.20
Trinidad and Tobago	TTO	64.10	49.50	0.09
Tunisia	TUN	57.75	41.40	-0.29
United Kingdom	GBR	75.84	33.00	1.40
United States	USA	76.18	47.70	1.21
Uruguay	URY	68.56	43.00	0.77
Venezuela, RB	VEN	34.34	36.00	-1.31
Zimbabwe	ZWE	37.64	37.00	-1.32

Note. Author's calculations based on the data described previously.

**Appendix Table 3: Total Factor Productivity (TFP), Capital (K), Working Population (L), and Population**

Country Name	Country Code	TFP	K	L	Labor Share	Population
Argentina	ARG	48.15	1930000000000	15293299.67	0.43	42980026
Australia	AUS	349.38	3190000000000	11828481.67	0.57	23490736
Austria	AUT	550.65	1020000000000	4237696.65	0.61	8534492
Belarus	BLR	407.78	371000000000	4661747.93	0.62	9470000
Belgium	BEL	664.43	1230000000000	4685547.83	0.62	11225207
Benin	BEN	123.78	32994687500	3731556.18	0.62	10598482
Bolivia	BOL	38.34	94314007813	3906682.73	0.45	10561887
Botswana	BWA	5.07	81803257813	1055689.33	0.25	2219937
Bulgaria	BGR	72.05	2280000000000	3570633.89	0.47	7226291
Burkina Faso	BFA	73.87	39780214844	7907936.57	0.58	17589198
Cameroon	CMR	54.42	86194460938	8545168.88	0.50	22773014
Canada	CAN	432.68	3680000000000	17534931.18	0.58	35540419
Chile	CHL	57.13	7090000000000	7774331.57	0.45	17762647
Colombia	COL	58.50	1310000000000	19768640.52	0.48	47791393
Costa Rica	CRI	377.82	88620921875	2134618.52	0.62	4757606
Croatia	HRV	575.99	2580000000000	1450284.60	0.64	4236400
Cyprus	CYP	228.39	77559156250	314050.53	0.56	1153658
Czech Republic	CZE	252.09	8660000000000	5243259.91	0.57	10510566
Denmark	DNK	1462.19	6550000000000	2827669.86	0.69	5639565
Dominican Republic	DOM	25.60	2370000000000	3892576.22	0.38	10405943
Estonia	EST	377.37	68929070313	615745.31	0.61	1313645
Fiji	FJI	73.56	9598720703	310819.80	0.50	886450
Finland	FIN	500.00	6730000000000	2570416.93	0.61	5463596
France	FRA	686.08	6880000000000	26846227.65	0.63	66206930
Germany	DEU	577.86	8870000000000	41380241.39	0.61	80889505
Greece	GRC	140.25	9450000000000	4707114.22	0.52	10957740
Guatemala	GTM	39.55	91310171875	5076175.69	0.42	16015494
Honduras	HND	138.45	61474761719	3303510.67	0.60	7961680
Hungary	HUN	420.92	5140000000000	4083425.05	0.61	9861673
Iceland	ISL	2387.49	44620746094	174874.72	0.75	327589
Indonesia	IDN	41.72	3270000000000	109532898.00	0.47	254454778
Iran, Islamic Rep.	IRN	7.85	2810000000000	25270198.82	0.26	78143644
Ireland	IRL	349.06	3660000000000	1753842.12	0.53	4612719
Israel	ISR	299.89	5630000000000	3355351.92	0.56	8215300
Italy	ITA	236.40	7410000000000	24637393.95	0.55	61336387
Jordan	JOR	64.30	1630000000000	1543298.72	0.48	6607000

Country Name	Country Code	TFP	K	L	Labor Share	Population
Kazakhstan	KAZ	31.48	655000000000	7953701.50	0.41	17289111
Kenya	KEN	231.81	120000000000	15756555.56	0.67	44863583
Korea, Rep.	KOR	226.21	525000000000	24063535.69	0.55	50423955
Kyrgyz Republic	KGZ	73.03	27652955078	2339370.25	0.53	5834200
Latvia	LVA	273.06	89634726563	871431.17	0.58	1990351
Luxembourg	LUX	152.15	110000000000	379394.05	0.50	556074
Malaysia	MYS	155.87	1380000000000	12438889.50	0.53	29901997
Mauritius	MUS	48.36	42128019531	601482.15	0.42	1260934
Mexico	MEX	23.86	3840000000000	45226406.10	0.37	125385833
Moldova	MDA	228.49	51884636719	1083489.06	0.63	3556400
Mongolia	MNG	45.14	75486835938	1084748.74	0.48	2909871
Morocco	MAR	69.02	430000000000	11332844.73	0.50	33921203
Netherlands	NLD	644.07	1830000000000	8712311.74	0.61	16854183
New Zealand	NZL	147.19	290000000000	2289174.56	0.51	4509700
Norway	NOR	338.28	719000000000	2755358.46	0.54	5136475
Paraguay	PRY	127.47	80367609375	3012250.42	0.56	6552518
Philippines	PHL	26.47	1180000000000	34641120.91	0.41	99138690
Poland	POL	258.49	1790000000000	15975003.24	0.56	37995529
Portugal	PRT	774.86	900000000000	4829286.10	0.67	10397393
Russian Federation	RUS	379.76	7410000000000	68079681.40	0.62	143819569
Senegal	SEN	13.63	77017367188	5147195.82	0.39	14672557
Slovak Republic	SVK	216.68	300000000000	2206067.80	0.54	5418506
Slovenia	SVN	1074.40	207000000000	963533.88	0.69	2062218
South Africa	ZAF	155.12	979000000000	18651678.09	0.52	54001953
Spain	ESP	830.60	4810000000000	18444431.30	0.65	46404602
Sri Lanka	LKA	765.53	291000000000	7133561.13	0.70	20639000
Swaziland	SWZ	304.82	23751517578	376683.09	0.63	1269112
Sweden	SWE	911.76	694000000000	4788344.38	0.64	9689555
Tajikistan	TJK	7.57	57231378906	1923102.62	0.30	8295840
Trinidad and Tobago	TTO	35.20	28549564453	667181.37	0.34	1354483
Tunisia	TUN	55.51	265000000000	3855111.12	0.45	10996600
United Kingdom	GBR	826.86	4950000000000	29042301.18	0.63	64510376
United States	USA	804.74	40900000000000	141807022.10	0.62	318857056
Uruguay	URY	58.15	133000000000	1560279.73	0.46	3419516
Venezuela, RB	VEN	21.27	893000000000	10180869.10	0.36	30693827
Zimbabwe	ZWE	310.75	9252796875	7419908.52	0.56	15245855

Note. Author's calculations based on the data described previously.