Chapter 2

Guatemala: Marked by Deficiencies in the Allocation of Property Rights

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<td>GDP per Capita (at 2011 PPP $)</td>
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<td>Genders in 2nd Schooling (female/male) most recent</td>
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<td>Employment to Population Ratio (% aged 15+) 2012</td>
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<td>Unemployment rate (% aged &gt; 15) 2004-2013</td>
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<td>Ratio Female/Male Labour Force (percent) 2013</td>
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<td>Children in Employment (% of age 7-14) 2013</td>
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<td>Net Migration Rate (pers. /1'000) 2010/2015</td>
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<td>Rural Population (% of popul.) 2014</td>
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<td>CO2-Emission (t per capita) 2011</td>
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<td>Improved Water Access (% of popul.) 2014</td>
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<td>Forest Area, Change (% 2005 value) 1990 to 2012</td>
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<td>National Resource Rents (% of GDP) 2014</td>
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<tr>
<td>Protected Area (% of surface) 2014</td>
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<td>Human Development Index (HDI) (0&lt;Value&lt;1) 2014</td>
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<td>0,627</td>
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</tbody>
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Chapter 2
Guatemala: Marked by Deficiencies in the Allocation of Property Rights

To produce export crops can constitute an enormous challenge for the social cohesion within a country. This holds particularly true when these export crops are cultivated in plantations and do not constitute a welcome diversification within small scale farming. In divided societies, long lasting and extremely violent conflicts can arise out of such a situation. To allocate exploitation rights properly is rendered particularly difficult when in the initial situation property rights are not registered and enforced by governmental institutions but are based in customary law. Social equity may make it necessary to officially allocate exploitation rights and to seize the opportunity to correct deficiencies of the traditional rules in place; one may think of the discrimination of women in land ownership or the overexploitation of the commons. Any such process is exposed to the risk of a reversal to the initial situation, however, or may derail in other ways. It will often not occur with the necessary democratic legitimation so that those already in power or those that successfully fight for power in the transition will be unduly favoured. This is all the more tragic as an uneven distribution of property rights can inhibit development for decades, putting a burden also on future generations, and not only the generation making the often sad experiences of a fundamental economic and social transition.

The chapter reports in part I the ongoing difficulties Guatemala knows in coping with the deficiencies that affect the country’s attribution of land ownership as inherited from colonial times.

Part II then resumes empirical studies on the connection between social equity and growth. The finding is that not income inequality as such is inhibiting growth and development but an uneven distribution of assets at the outset.

Countries are sovereign in defining their regime of property rights. But exactly due to this fact they have a problem in attracting foreign direct investment. Investment treaties, the topic of part III of the chapter, allow governments to credibly commit not to loot the foreign investor once the investment is in place within their jurisdiction. The actual characteristics of investment treaties rise however a number of concerns.

The business case in this chapter then reports on a participation of a Swiss enterprise in a mining company. Caused by the social cleavages in the country, the project became increasingly marked by violent clashes, leading the company to finally sell its stake in the venture.

Part IV shows that to allow foreign ownership of land had but favourable consequences for a Swiss town in the 2nd half of the 19th century, thus questioning the economic soundness of the widespread provisions which make access to land for foreigners much more difficult than access to other assets with which the owner can effectively run away.

Part I
Guatemala: A Country ridden by Violent Conflict over Property Rights

1.1 Main features of the country and its population

The Republic of Guatemala has a population of 16.0 million inhabitants and a surface of 108,890km², making it a country with considerable population density. Spanish conquerors at the beginning of the 16th century encountered a Mayan population that extended into Belize, the southern part of Mexico and eastern parts of El Salvador. After independence from Spain in 1821, the country suffered much of the political instability that characterized the region during the rest of the 19th century. Exposed to strong U.S. influence, Guatemala experienced also in the 20th century a mixture of democratic governments and military regimes. Only after the end of the civil war fought between the government and leftist rebels from 1960 to 1996 did Guatemala witness perceptible economic growth and elections satisfying basic democratic principles.

A representative democracy, Guatemala is member of the Organisation of American States and the CELAC, the Community of Latin American and Caribbean States (where the USA and Canada are not members). Since 2005, the country is participating in the Dominican Republic-Central America Free Trade Agreement led by the USA; it has also concluded free-trade agreements with the EU and EFTA and founded a customs union with El Salvador; moreover, a free trade agreement with Mexico was adopted in 2013.
Castañeda was forced to resign in response to then on. On Company, a major force in Guatemala fr presidency was helped by the United Fruit Manuel Estrada Cabrera, whose access to the to 1920, Guatemala was ruled by the dictator when trying to conquer El Salvador. From 1898 good. He tuning, coffee becoming an important export trade, and introduced new crops and manufac-
mala's "Liberal Revolution" in 1871, Justo Ru-
ernance in the Capitanía General de Guatemala,

sites dating back to 6500 BC have been found and indications that maize cultivation was de-
veloped by 3500 BC. Early traces of monumen-
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the Maya civilization was reached in the Classic period (250 BC to 900 AD) with the develop-
ment of independent city-states and the con-
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writing, epigraphy, and the calendar did not
originate with the Maya; however, their civiliza-
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Classic Maya civilization collapsed for uncertain
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Spanish contact resulted in an epidemic that
devastated native populations. Among a domi-
nant Mestizo population, several families of
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nence in the Capitanía General de Guatemala,
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bordered by Mexico to the west and the north,
Belize to the northeast, the Caribbean Sea to the
east, Honduras and El Salvador to the south-
west. Two mountain chains enter Guatemala
from west to east, dividing the country into three
major regions: humid tropical lowlands and
colder, drier highlands, all major cities being lo-
cated in these regions, plus the Petén, native
forests in the north-east, being only sparsely
populated. The country suffered from several
major earthquakes in historic times, including a
7.5 magnitude tremor on 4 February 1976
which killed more than 25,000 people, experi-
ences recurrently severe hurricanes and was also exposed to volcanic eruptions.

History

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mortality among political candidates and activists in the run-up to polls, won by Alvaro Colom of the centre-left National Unity of Hope Party with nearly 53 percent of the votes. In the latest elections in 2011, retired General Otto Pérez Molina of the Patriotic Party won the presidential election in a runoff against populist Manuel Baldizón of the LIDER party. Molina was forced to resign on 3 September 2015 after the Highest Court denied him immunity from corruption allegations and imprisoned a few days later. Overall, murders, often linked with drug trafficking, and natural disasters continued to affect the country negatively since the peace agreement in 1996, all these evils being combined with corrupt politics.

A slight majority of the population are Mestizo (i.e. mixed Amerindian-Spanish) and European, different indigenous Mayan groups accounting for approximately 43% of the population. Population growth remains high, with some 2.5%, so that the current population is twice what it was 25 years ago and is expected to double again in the next 25 years. The fertility rate is a high number of 3.8 children per woman in the relevant age group.

Guatemala has some of the lowest human development indicators in the hemisphere and the highest level in the hemisphere of chronic malnutrition (49.8%) for children under five years of age. Only 78.3% of the population aged 15 and over are literate, the lowest literacy rate in Central America, but the situation is improving. Enrolment at the secondary and tertiary level is encouraging (65% and 19% respectively) while the ratio of girls to boys at the secondary level remains below parity. In the labour market, the female participation rate is considerably lower than that of men. Elementary and secondary-level schools are free, though the cost of uniforms, books, supplies, and transportation makes them less accessible to the poorer segments of society, a fact that adds also to the significant number of school dropouts. Many middle and upper-class children go to private schools. The country has one public and nine private universities.

Catholicism was the official religion during the colonial era. However, the practice of Protestantism has increased markedly in recent decades. In addition, traditional ceremonies continue to be performed, concomitant with Maya medical beliefs and practices.

Drugs add to the lack of personal security (see below). The legalisation of marijuana production is considered, hoping to tax production and use tax revenues to fund drug prevention programs and other social projects.

### 1.2 Main features of the economy

Guatemala reaches on average a considerable per capita income of US-$7,063 on a PPP basis (figure for 2013). Growth remains depressed however. The level in 2014 is only 43% above the one reached in 2004 and the growth rate over the period 2009-2014 was 3.6% p.a.. Gross fixed capital formation appears as insufficient to support stronger growth, confirmed by negligible R&D expenditures and internet usage well below the world average.

Together with Colombia, Guatemala reaches the highest inequality in income in the sample of 16 countries examined in this book (a GINI-index of not less than 52% is estimated by the World Bank for 2011). A remarkably high share of the population (14% in 2011) lives therefore below the lowest defined threshold of poverty of US-$1.25 a day. Concomitantly, child labour is a problem while the employment to population ratio is rather low.

The service sector is the largest component of GDP at 59.5%, followed by the industrial sector at 28.0% and the agricultural sector at 11.3% (2013 estimates). Tourism has become an increasing source of revenue for Guatemala (1.3 million arrivals). Industry exports some garment based on imported yarn but the importance of the ‘maquiladoras’ sector is not comparable to the one in Mexico. The agricultural sector accounts for about two-fifths of exports, mainly products for export are coffee, sugar and bananas as well as fruits, vegetables and flowers, and employs half of the labour force. Intriguingly, Guatemala imports nearly half of its corn from the United States while some 40 percent of its crop harvest (especially sugar cane and palm oil) is used for biofuel production. Mines produce gold and other precious metals, accounting for more than 10% of exports. Overall, integration in world trade is not very high with a value of imports plus exports divided by GDP of 58.6%.

The current account was in deficit with -2.1% of GDP in 2013 and an outflow of private capital was registered. The latter was nearly matched by FDI. The external debt stock is tolerable (33% in 2014). Official development aid reaches 0.9% of GNI. Since the Civil War forced many Guatemalans to start lives outside their country, remittances from Guatemalans who fled to the United States now

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110 See [https://atlas.media.mit.edu/en/](https://atlas.media.mit.edu/en/)

111 The Renewable Fuel Association contests (in the author’s view not very convincingly) an article in the New York Times arguing that this is a problem for

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constitute the largest single source of foreign income (one tenth of GDP).

Guatemala has an independent currency. In spite of a gradually appreciating real effective exchange rate (see graph below), exports have progressed over the last years. Macro-economic stability is also considerable when assessed by other indicators. Since 2010, the consumer price index has risen by 19 points or a rate of some 4% p.a. The price level is at 49% of the US level. Domestic credit by banks is poorly developed (40.6% of GDP in 2012).

While the general government deficit was tolerable with 1.9% of GDP in 2013, the general government expenditures were a very low 13.4% of GDP. At the present rate of tax collection, the government is deprived of essential means to meet the pressing needs of the country. Corruption is considerable and the country scores average in the doing business indicator.

1.3 The challenges for development faced by Guatemala

Guatemala is one of the poorest countries in Latin America and, as indicated above, the distribution of income remains highly unequal with more than half of the population below the national poverty line. When Guatemala is considered a lower middle-income country, this is deceptive because the benefits of its economic strength are largely limited to the urban, non-indigenous population. This is tantamount to saying that the most significant cleavages in terms of social, economic and political opportunities are between the indigenous and non-indigenous and between the urban and rural populations.

The indigenous population has suffered a long history of repression and exclusion from participation and opportunity. There is pervasive racism on the part of both the economic elite and the non-elite Latino population. Most of Guatemala's poor are rural indigenous people of Maya descent who live in the highland regions where they combine subsistence farming with seasonal migration to coffee estates and sugar plantations in the southeastern lowlands and coastal areas. 74.8% of them live in poverty, more than twice the percentage of non-indigenous, and the indigenous' average 3.8 years of formal education are only half that of non-indigenous. Rural and indigenous children, particularly girls, represent the majority of children that are out of the education system. Guatemala is also characterized as a male-dominated or "machista" society, in both the Latino and indigenous populations.

Against this background and through a consultative process with numerous stakeholders, USAID Guatemala identified two significant underlying challenges to successful development in Guatemala, namely

- historic inequality that remains ingrained in Guatemalan society today, and
- weak government, lacking the capacity to redress insecurity and poverty.

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Taken separately, the report continues, each of these driving forces contributes to increased crime, high levels of poverty, and some of the region’s lowest health and education indicators. Combined however, their impacts are felt even more acutely: “As a result of both factors, Guatemalans lack protection against organised crime, face vulnerability to natural disasters and struggle to feed and educate their children.”

Only parallel improvements with regard to income, health and nutrition, and education of Guatemala’s rural poor will foster the sustainable rural development necessary for social and economic equity. Fortunately, in light of the alarming indications that follow, some significant improvements in terms of economic growth, health and nutrition, and education can also be reported, demonstrating the potential for development. These include (by 2011):

- Reduction of poverty by 12% since 1989 (5% of this occurred in the preceding six years).
- Reduction of chronic malnutrition by 14.5% since 1989 (6% of this occurred also in the preceding six years).
- Increased net primary school enrolment (from 72% in 1991 to 98% in 2008).

In a next step, seven priority areas for improvement are identified by the USAID report:

1. Move into citizen security, counter trafficking in persons and enhance civic responsibility
2. Support transparency, policy and institutional strengthening
3. Increase investment in local governance
4. Rethink education program
5. Expand agriculture programs
6. Expand environmental programs
7. Form public-private sector partnerships (PPPs).

With respect to the 7th topic, virtually nothing can be found in the text (presumably, to mention PPP is a political must). We replace this 7th topic with “Strengthen the role of women in communities”. We raise the issue of gender is, of course, also a political must, but in this regard, the report has substantive points to make. With this change, the choice of the seven priority areas appears aligned to the findings of other reports on the major challenges Guatemala faces.

In what follows, we put relevant findings - widely dispersed in the document - under these seven headings:

1. Move into citizen security, fight trafficking in persons and enhance civic responsibility

Security is a basic human need which, when lacking, inhibits development in other sectors. Tragically, Guatemala is increasingly threatened by the effects of impunity and corruption. Escalating crime rates and the corrosive effects of gangs, organised crime, and transnational illicit trafficking of narcotics, persons, weapons and contraband make Guatemala one of the most dangerous countries in Latin America. This is even more worrying when one considers that the Latin America and Caribbean (LAC) region has the world’s highest homicide rate among men between the ages of 15 and 29. Crime and violence are now recognized as serious economic and social problems with very high economic and social costs, especially in poor urban areas. Particularly worrisome is the fact that youth (15-24 year-olds) in the region is disproportionately involved in violence as both victims and perpetrators.

Corruption and mismanagement undermine the effectiveness and public confidence in the police forces and the judicial system. The police forces not only lack of sound management practices, they show also low professional ethics and are not governed by democratic principles. This deficiency, among others, limits the ability of the police to respond to high crime rates and gain public trust. Adequate management is necessary for officers to ensure that security forces operate in a manner consistent with democratic practices, and that agents have the institutional and logistical support to be motivated, trained and well equipped to perform their mandate. The widely recognised problem of impunity and corruption is enhanced by the deficiencies in the judicial system. In a study of the justice system conducted by the World Bank in 2005, more than 70% of Guatemalans considered the justice system to be ma-

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113 The report covers gender issues as it should be as a transversal theme under the other headings.
114 We refer to the documents regularly produced on Guatemala by international organisations such as the World Bank, the Inter-American Development Bank or the IMF. Specifically on property rights over land, the following documents contain also useful information: Annalisa Mauro, Michel Merlet: Access to Land and Recognition of Land Rights in Guatemala, International Land Coalition, June 2003, or Lisa Viscidi: Land Reform and Conflict in Guatemala, La Plataforma Agraria, September 2004.
nipulated by the government and by powerful eco-

nomic and political interests. Accordingly, only

41.3% of Guatemalans said they trust courts.\textsuperscript{115}

In Guatemala, corruption has the greatest relative

impact on the members of society with the lowest

status, which usually include women. Petty cor-

ruption in the form of bribes associated with day-
to-day activities – school fees, registrations,

health services – tend to affect them more than

men since these payments come out of their

pocket.

2. Support transparency, policy and institutional

strengthening:

Assessed on available statistics, pressures for

public spending are enormous. Guatemala has

the worst rates of chronic malnutrition in the West-

ern Hemisphere (49.8% of children under the age

of five), the health, education, and economic con-

sequences of chronic malnutrition being long-last-
ing and severe. Another challenge are destructive

weather events, volcanic eruptions and earth-
quakes which pose nearly annual threats to Guat-

emala’s agricultural production, infrastructure

and human lives. The ability of the government

and economy to mobilize resources after events

of major scale remains limited, however. Efforts to

adapt, prevent and mitigate natural disasters are

also limited. Overall, government institutions

responsible for security, health, nutrition and essen-
tial public services do not have the resources to

tackle the challenges posed by increasing crime

and violence, the country’s high levels of malnu-

trition and other health issues, or to foment the

economic development needed to reduce the

country’s high levels of poverty. Historically low

levels of tax revenue, an inadequate fiscal sys-
tem, and fiscal evasion add to the problem of an

underfunded government where, furthermore,

corruption limits the efficiency of government

spending. A key issue for Guatemala remains the

low level of tax revenues (around 11 percent of

GDP).

Consequently, the budget of the Ministry of Health

has sunk to just 1% of the Guatemalan GDP, se-

verely affecting programs that serve the most vul-
nerable populations: rural health service delivery,

vaccine and contraceptive procurement, as well

as human resource development. Similarly, the

Ministry of Education budget accounted for only

3.4% of GDP. Despite missing funds, Guatemala

has made progress in narrowing educational gaps

(see below) and in improving health disparities.

The infant mortality rate, currently at 34 per 1,000

live births, is on track to achieve the Millennium

Development Goals’ target. Total fertility fell from

5.0 in 1999 to 3.6 in 2009 with a comparatively

greater decrease for indigenous women from 6.2

in 1999 to 4.5 in 2009. Meanwhile, contraceptive

prevalence rates increased to 54% and skilled birth

testance increased to 51%. Prenatal care cover-

age rates are the same among urban, non-indige-

nous and rural, indigenous women, and

immunization rates are the same for these groups

of children. A significant contributor to these im-

provements is foreign aid.

3. Increase investment in local governance:

While most of the focus in the US report is on im-

provement and strengthening of Security and Ju-

dicial System Institutions (SJSIs) at the national

level, USAID recognizes the key role that local

governments play. Strengthened local govern-

ments will be in a better position to respond to cit-

izen concerns related to personal safety, food se-

curity, disaster prevention and other issues of

concern to the community. The challenge of work-

ing in a culturally diverse geographic area with a

multitude of languages, customs and dialects can-

not be underestimated. The endogenous popula-

tion speaks Spanish often only as a second lan-

guage, besides one of the numerous Mayan

dialects.\textsuperscript{116}

4. Rethink education programs:

Guatemala has almost reached universal cover-

age of primary school enrolment. During the

1990s, specific girls education programs were

launched and helped bring the primary school net

enrolment rates near parity (2009: 99% for boys;

92% for girls, total net enrolment rate 98%). How-

ever, there are still few children in pre-primary

school (44%), lower secondary school (29%) and

upper secondary school (18%). Furthermore, ad-

vances in sixth grade completion have been mini-

mal due to lack of access, especially in remote

rural areas, and generalized high dropout, repeti-

tion and failure rates. Only about three-fourths

of those enrolled in primary school complete the full

cycle (80% boys and 73% girls). These low levels

of completion and high levels of repetition and de-

sertion result in a labour force that is ill prepared

to compete in an increasingly global market. Al-

though young male drop-outs are usually seen as

a threat, the long-term risks for society related to

dropping out of school may be greater for young

women. The reason is the clear link between the

education of girls and family well-being, including

health, nutrition, children’s education and family

planning. Deficiencies in educational quality and

student outcomes are largely related to the poor

preparation of teachers.

\textsuperscript{115} http://www.vanderbilt.edu/lapop/survey-
data.php

\textsuperscript{116} In the author’s view, an explicit statement that a

sufficient number among the police forces should

be of indigenous origin is missing.
5. Expand agriculture programs:

Populations in the highlands live in isolated communities and have a single maize harvest per year with few options for generating income. Poverty in urban areas is another reason why Guatemala remains vulnerable to food security crises, opening the delicate question of the conditions under which foreign food aid is provided.

Among agricultural value chains, due to the altitudes and soil types, coffee and horticulture are the best positioned of all to increase rural incomes. But international commodity prices, especially for coffee, continue to be uncertain. This uncertainty carries with it the potential for abrupt changes in rural income. Increasing the productivity of food crops grown for home consumption is one proven way to reduce food risk and enable the transition to commercial production. To diversify into horticulture export products is another. To this end, Guatemala has urgently to improve its sanitary and phytosanitary systems or the country may lose the opportunity to continue selling in existing markets and to open new ones. Inspections of some products exported from Guatemala to U.S. markets have revealed unacceptable levels of pesticides during the last few years.

6. Expand environmental programs:

Guatemala is one of the most vulnerable countries worldwide to natural disasters. Deforestation is likely to add to this exposure. Since 1950, 60% of its trees have been lost. Compounding the effects of weak governance with respect to natural resources is the shortage of legitimate economic opportunities faced by rural Guatemalans. The resulting unsustainable human activities mean:

- Habitat loss, degradation and fragmentation as a result of uncontrolled fires, of land conversion for plantations and cattle, of land conversion for mineral and petroleum development and of the introduction of exotic or opportunistic species;
- Over-exploitation of natural resources, specifically due to poorly managed forest product harvests, unregulated hunting and collection of wildlife for illicit national and international markets, and poorly regulated harvests of marine life;
- Environmental contamination from poorly-managed liquid, solid, and atmospheric wastes, agricultural runoff, and ineffective regulation of mineral and petroleum development.

7. Strengthen the role of women in communities:

Barriers to participation in decision-making affect women at the household and at the community level. Women and indigenous people are under-represented in governmental institutions. The representation of women in the national legislature falls below the Latin America and Caribbean average of 17%. Biases extend to women’s participation as members in farmers groups or cooperatives, and particularly against their presence in decision-making positions within the groups. Consequently, they are restricted in their access to inputs, information, and markets. Furthermore, both horticulture and coffee production are labour intensive activities. As production increases, the requirements for unpaid family labour of women and children grow. Simultaneously, while household income will increase with the participation in value added chains, the question remains of who will control the extra cash revenue obtained and what this means for food and non-food expenditures. Educational deficiencies combined with doubtful social and commercial influences may lead to an unproductive utilisation of the increase in income. Finally, although there are no legal restrictions on women’s access and rights to land ownership, the percentage of female landowners is extremely low due to prevailing patriarchal influences. Within indigenous communities, women are even more marginalized.

1.4 The role of land ownership in national history

Guatemala has the most inequitable and concentrated distribution of land ownership in Central America. For centuries, indigenous Guatemalans faced systemic exclusion from access to land. During colonization, the Spanish expropriated indigenous lands to create plantations, and forced the population onto ever-smaller plots at higher elevations. The Spanish engaged the indigenous population as workers on the plantations or as tribute payers on communal lands. This land policy continued for 50 years after independence, when communal land was converted to private property through low-priced sales. As a result, many indigenous people became workers on coffee plantations. Until the mid-twentieth century, government administrations worked to dispossess indigenous groups of their land. Currently, box on Colonel Árbenz relies essentially on the corresponding entry in Wikipedia.
40% of the economically active population is landless. Indigenous populations are overrepresented within this group.

Up to date, a long-standing landed oligarchy controls vast tracts of productive land and maintains political influence over land and labour issues. Land distribution is highly unequal, the highest levels of land concentration are in departments with the most fertile land. The largest 2.5% of farms occupy nearly two-thirds of agricultural land while 90% of the farms are on only one-sixth of the agricultural land. Six percent of cropland is irrigated and used for cash and export crops, mainly vegetables and sugar cane.

In contrast, subsistence farmers cultivate small parcels on increasingly eroded hillsides, primarily in the Western Highlands. In impoverished regions such as the western and north-western departments, farm parcels range from 0.5 to 2 hectares per family. These departments also have the highest density of indigenous populations, as well as the highest rates of poverty and social marginalization in the country. Most food-insecure villages are almost entirely indigenous.

The government’s attempts to redistribute land between 1951 and 1954 were short-lived as a military coup in 1954 ended and reversed the redistribution (see box to the right). The new government returned land rights to previous owners at an average holding size of 3,000 hectares. Subsequently, the historical and pervasive inequality in land distribution was a fundamental contributor to the country’s 36-year civil war. During the conflict, an estimated 130,000 – 200,000 people were killed; 50,000 were reported ‘disappeared’; 100,000 became refugees; and 200,000 children were orphaned. Additionally, the Guatemalan Civil War and resulting human rights abuses led to the displacement of between 500,000 and 1.5 million people. These internally displaced persons (IDPs) were dispersed across the country but many ended in the slums surrounding Guatemala City. IDPs are among Guatemala’s poorest residents and are vulnerable to food insecurity and malnutrition. As of 2007, 2.6 million people – or 40% of the urban population – lived in slums.

The Peace Accords attempted to address land issues, including access for the poor, legal reform, and land administration. However, political will for reform has been limited, as the next section will show, so that a highly inequitable land ownership persists.

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**Colonel Jacobo Árbenz Guzmán**

Colonel Jacobo Árbenz Guzmán (14 September 1913 – 27 January 1971) was a Guatemalan military officer and politician of Swiss origin who served as Defence Minister of Guatemala from 1944 to 1951, and as President of Guatemala from 1951 to 1954. He was ousted in a coup d’état engineered by the United States government and CIA and was replaced by a military junta headed by Colonel Carlos Castillo.

Árbenz was born in Quetzaltenango, Guatemala, as the son of a Swiss German pharmacist who immigrated to Guatemala in 1901 and a Guatemalan mother. His family was relatively wealthy and upper-class but his father, addicted to morphine, ran the family into bankruptcy. Árbenz therefore had to apply for a scholarship available through the Escuela Politécnica for military cadets, run by U.S. army officers, where he excelled. After graduation in 1935, he remained at the academy, teaching different subjects. In 1938, he met his future wife María Vílanova, the daughter of a wealthy Salvadoran landowner who acquainted him with Marxism.

In these years, the dictator General Jorge Ubico was in power, backed by the United States. He had initiated one of the most brutally repressive military juntas in Central American history while giving away hundreds of thousands of hectares to the United Fruit Company (UFCO), exempted them from taxes, and allowed the U.S. military to establish bases in Guatemala. Ubico’s repressive policies and arrogant demeanor eventually led to a widespread popular insurrection led by middle-class intellectuals, professionals, and junior army officers. On 1 July 1944, Ubico resigned from office amidst a general strike and nationwide protests.

Among the military officers in the opposition were Jacobo Árbenz and Major Francisco Javier Arana. Ubico had fired Árbenz from his teaching post at the Escuela Politécnica, and since then Árbenz had been living in El Salvador, organising a band of revolutionary exiles. On 19 October 1944, a small group of soldiers and students led by Árbenz and Arana attacked the National Palace in what later became known as the "October Revolution". Ponce, an army general who had succeeded Ubico, was defeated and driven into exile; and Árbenz, Arana, and a lawyer named Jorge Toriello established a junta. They declared that democratic elections would be held before the end of the year.
The winner of the 1944 elections was a philosophy professor named Juan José Arévalo who started to implement social reforms. Arévalo did not trust Arana and installed Árbenz as the minister of defence to act as a check on Arana, who was mysteriously killed in 1949, leaving Árbenz without any serious contenders in the elections of 1950.

In his inaugural address, Árbenz promised to convert Guatemala from "a backward country with a predominantly feudal economy into a modern capitalist state." He declared that he intended to reduce dependency on foreign markets and dampen the influence of foreign corporations over Guatemalan politics. He also stated that he would modernise Guatemala's infrastructure and do so without the aid of foreign capital. As only 2% of the population owned 70% of the land, Árbenz set land reform as his central goal and enacted in June 1952 a corresponding reform program. The law empowered the government to create a network of agrarian councils which would be in charge of expropriating uncultivated land on estates that were larger than 672 acres (2.7 km²). The land was then allocated to individual families. Owners of expropriated land were compensated according to the worth of the land claimed in May 1952 tax assessments (which they had often dramatically understated to avoid paying taxes). Land was paid for in twenty-five year bonds with a 3 percent interest rate. The program was in effect for 18 months, during which it distributed 1'500'000 acres (6'100 km²) to about 100'000 families. Árbenz himself, a landowner through his wife, gave up 1'700 acres (7 km²) of his own land in the land reform program.

The land reform was ruled unconstitutional by the Supreme Court, which he then purged. According to a report by a commission of historians (Comisión para el Esclarecimiento Histórico (CEH)), released in 1999, Árbenz had hundreds of political opponents killed during a military intervention he led in 1954.

Reflecting the anxieties of the time, and in accordance with the Monroe Doctrine, the CIA was concerned about Guatemala becoming a Communist puppet-state and eventual ties of President Árbenz Guzmán to the Soviet Union. In addition, and not surprisingly, the United Fruit Company had been lobbying the CIA to oust reformist governments in the Republic of Guatemala since the time of the Government 1945–51 of President Arévalo; but it was not until the Eisenhower Administration (1953–61) that the CIA received attention from the White House. In 1954, the Eisenhower Administration was flushed with victory from the 1953 Iranian coup d'état that deposed the Government of PM Mossadegh.

On 19 February 1954, the CIA began Operation WASHTUB, the planting of a false Soviet arms-cache in Nicaragua, to publicly demonstrate Guatemalan Government ties to the Soviet Union. More importantly, a Guatemalan–Czechoslovak arms deal for cash money became publicly known, as the Árbenz Government had started to resupply the Guatemalan armed forces, because it was convinced that a U.S.-sponsored paramilitary invasion was imminent. Effectively, the Eisenhower Administration ordered the CIA to execute Operation PBSUCCESS, a coup d'état to depose the Árbenz Government of Guatemala. President Jacobo Árbenz Guzmán resigned on 27 June 1954. The installed military government (1954–57) of Colonel Carlos Castillo Armas allowed him, and others, to seek political asylum in the Mexican embassy, en route to leaving Guatemala. Árbenz initially stayed in Mexico, then moved to Switzerland, later to Paris, Prague and Moscow, before establishing 1957 in Uruguay, the year he joined the Communist Party. In 1960, after the Cuban Revolution, Fidel Castro asked Árbenz to come to Cuba, a suggestion that Árbenz readily agreed to. In 1965, Árbenz was allowed to return to Mexico to bury his daughter who had committed suicide, and eventually was allowed to stay. On 27 January 1971, Árbenz died in his bathroom, either from drowning or scalding.

In May 2011, the Guatemalan government signed an agreement with his surviving family to restore his legacy and publicly apologize for the government's role in ousting him. This included a financial settlement to the family. The formal apology was made at the National Palace by Guatemalan President Álvaro Colom on 20 October 2011 to Jacobo Árbenz Villanova, his son, a Guatemalan politician.
1.5 The legislation afferent to land ownership

The Constitution makes the state responsible for providing indigenous communities with state lands necessary to their development. Implementation of this provision has been limited (World Bank 2006b). Guatemala still lacks a basic land law that describes basic tenure types and addresses indigenous rights to land. These shortcomings make it difficult to resolve land conflicts, and leave the indigenous population without the means to obtain legal certainty regarding their interests and rights to land.\(^\text{118}\)

The 1973 Civil Code provides general principles on possession, use, transfer (through inheritance, mortgage, lease, usufruct or purchase/sale) and ownership rights over real property, including land and its registration. A particularity of the Civil Code is that it states that land held communally by more than one owner will be registered in the name of one of the owners only. Problematic is also the 1880 Law of Supplementary Titles which allows for the acquisition and ownership of land via a series of administrative steps without requiring proof of continued occupation of the land. This law has been heavily criticized for the lack of checks confirming that the land is vacant and for ignoring the rights of Mayan communities.

A governmental land-purchase program, FON-TIERRAS, facilitated access to land by individuals and communities through low-interest loans. However, the land-purchase program portion of FON-TIERRAS has been suspended. One study indicated that soon after people received title to their land, they sold it due to outside pressures and threats of violence. More recently, the State’s Real Estate Property Adjudication, Sale or Usufruct Law governs the state’s transfer of real estate rights to people with low income and wealth levels.

In practice, several tenure types exist, including private ownership, communal, use (colonato/usufructo), leasehold, municipal, and state. Communal lands include those in property, possession or tenancy of indigenous or peasant communities as collective entities with or without legal title. In some areas, common ownership has evolved into individual ownership. Tenure in informal settlements is very insecure; forced evictions, sometimes violent, have been common.

Foreigners have the same rights of use, benefit and ownership of property as Guatemalans. However, foreigners may not own land adjacent to rivers, oceans, or international borders.

Rules for registering land rights are set forth in specific legislation dating from 2005 back to 1880, as well as in the Civil Code. The 2005 Cadastral Information Registry (RIC) Law provides a detailed process for establishing and maintaining the cadastre. The 2002 Municipal Code provides for municipalities’ cadastre responsibilities, including establishing and maintaining municipal cadastres through the municipal planning office. As of 1998, 30% of the country’s properties were registered, though the majority of registered properties were located in urban areas. In contrast, 95% of rural parcels were not registered. The Government of Guatemala and the World Bank planned to title 50% of the country by 2013. The General Property Registry coordinates with the Registry of Cadastral Information.

The rental market is limited and highly imperfect. There are land rentals to campesinos, but these are temporary and insecure. Landowners perceive a risk to their property rights in granting long-term leases to campesinos. Courts are also perceived as lacking neutrality on land issues. Although the Peace Accords contemplated the creation of specific land courts, none yet exist.

The World Bank and a number of donor countries financed projects focusing on increasing the security of land tenure, including the provision of cadastral services in additional departments. Beyond USAID those include the German GTZ (US-$ 1.3 mio); the Netherlands (US-$ 6.9 mio); Norway (US-$ 4.1 mio); Spain (US$ 0.6 mio); Sweden (US-$ 2.2 mio); and Switzerland (US-$ 7.6 mio). The Swedish International Development Agency (SIDA) promotes among other activities the indigenous justice system as a complement to the national justice system.

1.6 Management and access to Natural Resources

Water

Water use is divided among the agricultural (80%), industrial (13%), and domestic (7%) sectors. Ninety-eight percent of the urban population and 88% of the rural population have access to an improved water source. Water resources are under pressure from growing demand. Deforestation and agricultural pressure on marginal farmlands have accelerated soil erosion, which degrades the water quality of Guatemala’s streams.

Forests
Approximately 36.3% of Guatemala’s area is forested, reduced from 65% in 1950. Of forested land, 38% is privately owned, 34% is nationally owned, 23% is municipal, and 5% lacks clear ownership rights due to conflicts or encroachment. The remaining 5% is used by the forest industry. In past decades, development and settlement policies contributed heavily to deforestation. Deforestation occurs at an annual rate of 1.3%. Guatemala has protected 23% of its total land area, including 32% of its forests. Over 90% of the national forests are in the Maya Biosphere Reserve in the department of El Petén.

Mining
The development of the extractive industries has been characterized by weak governance, and is tightly controlled by the powerful elite. In Guatemala, mining companies can be 100% foreign-owned. By 2005, the Government of Guatemala had granted over 115 new licenses to foreign mining companies, bringing the total to over 200 potential operations, nine-tenths of which were in the indigenous territories of the Highland. An open-pit gold mine, Marlin, is the subject of significant controversy. As a signatory to the International Labour Organisation (ILO)’s Convention 169 on Indigenous Peoples and Tribals in Independent Countries, the Government of Guatemala agreed that it will establish mechanisms for consulting local populations before permitting any exploration or exploitation activities (see the business case below in this text). The Law requires license applicants to submit either environmental mitigation studies that establish a work plan to reduce the potential environmental impact, or environmental impact studies.

The Significance of Globalisation for Guatemala
The country suffers from the cleavage in its society. Globalisation in the sense of allowing the trans-border flow of goods and capital may have exacerbated the situation in the case of this specific country. The single features globalisation takes on are in the case of Guatemala at best of medium importance for the future development of the country, however. Primordial is the seriousness of the internal problems.

Part II
The Economics of Property Rights

2.1 Distributional obstacles to enter a growth process
To obtain an intuition for the question we will consider in this section, we make reference to the offer curves figuring in the butterfly diagram we developed in Chapter 1. Below, we only reproduce the fourth quadrant of graph 1.3 where these offer curves figure and refer for their derivation to section 2 of Chapter 1. The question we will examine are the consequences when country A, the food exporter in the initial graph, can succeed in industrialising and exhibits after some time a transformation curve approaching in form the one for country B, the exporter of manufactures in the initial stage. Can situations arise where in country A deliberately a switch from an offer curve looking-like A1 as shown in the figure above to an offer curve looking like A2 – i.e. industrialisation119 – is suppressed? The term 'suppressed' is chosen deliberately since we consider the switch from offer curve A1 to offer curve A2 as depending on a series of structural reforms which may be favoured or blocked according to the interests of the elite in power. These can either be estate owners or industrialists.

Arguing based on the historical evolution, it is natural to consider the situation where the political power is vested with the land owners. When – through technological change and, possibly, redistributive measures – country A can switch to a transformation curve approaching the one of country B, the amount of food offered on world markets is lower at given exchange rates of food for manufactures. Clearly, switching to this transformation curve will improve the terms of trade of country A’s transformation curve in quadrant 1 of graph 1.3 in Chapter 1 favouring manufactures without significantly affecting food production possibilities, the food exporters within A should have shrinking of the trade volume. The latter is consistent with the concept of comparative advantage but contradicts the experience. To bring the model in line with the dominant observation of continuously growing trade volumes in the process of industrialisation, an explanation for intra-industry trade needs to be added to the model. This occurred in Chapter 3.
an interest in seeing this shift in the offer and transformation curves occur. So, prima facie, it is difficult to see why estate owners may have an interest in blocking the development of a dynamic manufacturing sector in an agrarian country at a low level of development.

In order to arrive at an opposite result, namely that producers of agricultural commodities will oppose the development of a manufacturing sector, a more elaborate model needs to be put in place. The essential additional feature of such a model consists in adding a labour-force to the model that neither owns land nor capital in the sense of produced means of production, but can only sell working hours. The question whether a country will enter a growth process may then critically hinge on whether the political power in the country is vested with the estate owners or with the industrialists.

Daron Acemoglu, a leading researcher in growth economics at MIT, studies such a constellation in the closed economy case. Among the various constellations that may arise, we concentrate here on one particular result he derives. In this constellation, the fact that the political power is the monopoly of the estate owners is not contested, i.e. they have to make only a small spending to defend their political privileges. The landed elite competes by the economic activities they deploy – we assimilate them with plantation farming - with the industrialists for workers. The salient point is that by appropriate policies, combined with an assumed finite number of estate owners and industrialists, demand for labour can be curtailed so that with given labour supply the wage rate tends to zero. In what can such policies limiting labour demand consist? Acemoglu considers a proportional tax on the output of either the manufacturing or the food producing sector. The product of these taxes ends either in the pockets of the political elite or is simply

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121 Acemoglu describes the entrepreneurs in the manufacturing sector as the middle class, not the industrialists.
122 A wage rate of zero is of course unrealistic. But a wage rate close to zero is best assimilated with a situation where the earnings of the labour force are reduced to the subsistence level (i.e. the Malthusian level, where the workforce earns just enough to reproduce itself). For a rural labour force, one may think of harvesters that are politically allowed to exploit marginal terrains during the year to cover their basic nutritional needs (and perhaps not even that (keyword: malnutrition of children)) and earn during the harvesting season the cash income indispensable to cover the remaining basic needs for survival.
wasted. The optimization problem of the elite when composed of estate owners consists in setting the tax rates so that the industrialists deploy some economic activity, thereby generating tax revenue, but expand activity not too much, because this would drive up the wage above zero and the latter would cut into the rent the estate owners derive from having their land exploited. Evidently, the elite does not tax itself, and in particular they do not do so when the tax revenues are wasted. Perversely enough, it can be optimal for the elite to tax the manufacturing activities even when the tax revenues are squandered; the benefit in terms of depressed wages when the manufacturing activities do not prosper too much may be enough to motivate such a policy (which has the advantage that the elite escapes the critique that government funds end in their pocket).

Acemoglu then shows that the risk of such detrimental policies for the country’s overall income may be enhanced when the political monopoly of the landlords is contested. In this situation, rent income out of the exploitation of natural resources and a better capacity of government to collect taxes will further aggravate the situation. This result hinges on the assumption that the risk for the estate owners to be deprived from power raises with the income of the industrialists. This is evidently just one possible way that may lead to a radical political change, however, since there is also a workforce.

Acemoglu insists that the outcome – a growth deadlock - is Pareto optimal. Pareto optimality means that there is no deal by which one party (in the present case the industrialists) could convince the other party (in this case the estate owners) to change their policy. This holds at least as long as a non-cooperative game is played, i.e. industrialists have no lever such as a boycott to bring the estate owners to the negotiating table and, additionally, both sides cannot credibly commit to respect any agreements reached if such negotiations would all the same take place.

One may deepen this point of optimality by considering the social welfare function that produces the same outcome as appears as Pareto optimal, and then extend the observations to the question of the ‘efficiency’ of market outcomes in general. The problem in the case where a growth deadlock occurs in Acemoglu’s model is “only” that the social welfare function going along with this Pareto optimal situation needs – in accordance with the distribution of political power- to be heavily biased by weighing quasi exclusively the revenue of the elite. However, the deadlock described may even be ‘efficient’ in a more common sense, namely when measured by GDP. It may indeed contribute more to GDP to tap the demand of a station wagon owner in the industrialised world having concerns regarding environmental pollution by producing biofuels in plantations and exporting the proceeds than by supplying an impoverished local population (by e.g. letting them rent more land). The widely heard assertion that markets are always efficient may hold true and justify biofuel production when current GDP is the efficiency criterion. The point escaping pro-market adherents is that market outcomes are not independent of the initial allocation of wealth. With a more balanced asset distribution, it is likely that domestic demand would not be so depressed and acquiring land for biofuel production would come at higher costs, making such a production less attractive. Additionally, it would become very difficult to defend the biofuel production as economically efficient if efficiency weren’t assessed in a static framework, i.e. based on market conditions prevailing actually, but when revenue from selling agricultural products domestically in a rapidly expanding economy were discounted and set against the revenue of biofuel production, the latter most likely only being economically viable in a situation with stagnating local incomes.

Then the former may dominate the latter in terms of the present values of the two development paths. Here again, the fact that the future middle-class cannot credibly commit to compensate estate owners for losing rent on land due to increasing wages is crucial. To sum up, there are a number of politically highly relevant subtleties going along with the different concepts regarding the economic or social “efficiency” of market outcomes.

As stated initially, Acemoglu derives these results for the closed economy case. This means that countries may find themselves deprived of growth prospects for purely internal reasons, foreign influences are not needed. A question of immediate interest therefore is whether globalisation makes it more or less likely that countries find themselves for distributional reasons trapped at a low level of development as described. In a recent paper, a model offering some answers to this question was proposed. Akerman, Larsson and Naghavi consider a small, potentially open economy, consisting of two sectors, agriculture...

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123 A second such policy consists in curtailing credit to the manufacturing sector or any competing producers (e.g. independent small scale farmers). This aspect is taken up in Chapter 15.

and manufacturing. Each sector produces a sector-specific good that is tradable in the world market. There are three groups of households that differ in their initial endowments and supply either land, capital or labour to firms. Labour moves freely between the two sectors so that a larger labour stock increases the returns to both land and capital. While labour consumes all the wage income, the elites only consume up to a level such that they can leave their initial endowment as a bequest to the next generations.

Akerman et al. (2011) now vary the assumption on the nature of the political elites and assume that they are either estate owners or industrialists. The autocratic government caters to the needs of the dominant elite and may thus be either land- or rent-minded or capitalist in nature. The autocratic government decides on the institutions relevant for productivity gains in the manufacturing sector and makes decisions on whether or not to allow a) for international trade in goods and b) for foreign capital inflows. It is important to note that increasing the institutional quality and thus spurring industrial development benefits also the rent on land, but indirectly, through a decrease in the relative price of manufacturing, as suggested by the graph above. However, similarly to the reasoning in Acemoglu (2009), there is also a second channel to consider: while capitalists undoubtedly benefit from institutions conducive to technological progress as they rise the marginal productivity of capital, by contrast, institutions conducive to manufacturing development hurt landowners by drawing labour out of agriculture, thereby decreasing the marginal productivity of land. The salient point now is that in an open economy, estate owners can satisfy their demand for manufacturing goods through imports, and internal prices are no longer relevant. Clearly, a higher world price of agricultural goods benefits estate owners and translates into a loss for industrialists. Given a scarcity of land in the other world regions, a land rent minded elite thus tends to open relatively early to trade while neglecting the institutions conducive to productivity increases in manufacturing.

Regarding the opening up to foreign capital inflows, the model considers two effects: Foreign capital reduces the returns on domestic capital due to the diminishing returns that go along with more capital. However, foreign capital has also beneficial technological spill-overs on domestic capital. The capitalist elite thus only favours capital inflows if the gains from the productivity spill-overs dominate the losses from the direct reduction in the marginal productivity of capital. The industrialists who in power will therefore be relatively reluctant to open up to trade as long as purely domestic measures conducive to productivity increases in manufacturing have not produced their major effects; also, under such circumstances, they do not want to share domestic investment opportunities with foreign capital and will block FDI. Once open to trade, the capitalist elite will favour relatively quickly also the opening up to FDI in order to benefit from the knowledge spill-overs, since from then on they will have to sell domestically at the world market price for manufactures. Opposite, a land rent oriented elite is more in favour of foreign capital inflows in an economy closed for trade than in a non-protectionist economy since in the closed economy case, foreign capital inflows will drive down the relative price of manufactures. To leave the economy closed is however contrary to their primary interest of exporting agricultural commodities. In the more relevant case of an open economy with a landed elite, the wage consequences of an increased competition for the labour force going along with more (foreign) capital become the dominant consideration of the land owners. Also a landed elite will therefore tend to block FDI.

Akerman et al. (2011) claim that the most common views on the development of Argentina, South Korea and Taiwan are largely consistent with their model where economic policy serves the interest of all political groups may also occur thanks to recurrent change in the governing party. To suppress such rotation is also a feature of autocracies.

125 The term autocratic is appropriate since a democratic government would, opposite to an autocratic government, have to consider the interest of all three groups in society. Adequate consideration of the interest of all political groups may also occur thanks to recurrent change in the governing party. To suppress such rotation is also a feature of autocracies.

126 The “relatively” is explained by the fact that industry uses to be interested in benefiting from economies of scale and therefore supports the extension of markets. Industry is more reluctant in opening up markets the more it fears that no compensation for domestic market share losses in the form of exports will accrue.
the labour force for industrial activities and to shape other framework conditions such as capital availability for small scale farms and businesses accordingly.\textsuperscript{127} It is the constellation with a small elite of real estate owners that are granted by the government under their control prerogatives over the development of key industrial sectors that is presumably most detrimental to overcoming a low level of development.

A shortcoming of the paper by Akerman et al. (2011) is that they introduce foreign trade and capital simply by the condition that, after opening up, the relative price of food and manufactures on the world market and the rate of return for capital prevailing abroad are determining domestic decisions. There is no relative price of (non-traded) domestic versus imported goods that needs to be balanced by the exchange rate in response to the (income dependent) propensities of the estate owners and industrialists to import. There are also no policy variables in the sense of a tax on manufacturing output as in the model of Acemoglu (2009). A possible extension of the model in these directions would consist in introducing tariffs and excise duties. At an overvalued currency, agricultural commodity exports buy a lot of goods while keeping domestic manufacturing depressed. To maintain an overvalued currency requires that import demand of the industrialists is curtailed by an appropriate mix of tariffs (high but not too high in sectors where domestic production may set in) and excise duties on consumer goods not produced domestically but that an urban middle class can afford out of their earnings in manufacturing (e.g. smaller cars).

One may note that the two models presented in this section are, to some extent, supportive of the theory of imperialism. The interests of the estate owners and of foreign manufacturers meet. The capital abundant industrialised countries are however only partly served by the policies an elite of estate owners vested with all the political power will find to serve their proper interest. Foreign owners of financial capital will presumably not be given the opportunity to invest in plantations and only the manufacturers of high touch consumer goods interesting the elite will find customers in the impoverished country. To us, the picture of a local elite organising the support of foreign powers by appropriate concessions\textsuperscript{128} appears as more realistic than the picture of a local elite established by foreign powers in order to act as jumping-jacks serving the latter’s interests. The fact that Latin American countries became independent as early as the 1820ies may be advanced in support of this view. The idea that the USA should control their backyard, i.e. Latin America, came later.\textsuperscript{129}

To make occasional references to situations prevailing in Latin American countries such as Guatemala as this is done here does of course not meet higher standards of scientific proof. In the next section, we will therefore consider if empirical studies underpin the relevance of the mechanisms emphasized by the purely theoretical models presented in this section.

\subsection*{2.2 Asset inequality more relevant for growth than income inequality}

The relationship between inequality and economic growth has received recurrent interest in the literature. How the consequences of inequality are analysed, along with the possible cures, operated, distant to the capital, in the two districts where industry had established in the 19th century. Tax declaration sheets for farms differed from those industry had to fill out and conveyed hidden benefits to farmers. Cross subsidisation of agriculture occurred e.g. also through non-adequate risk premia collected by the cantonal fire insurance monopoly. Such anecdotal evidence for policies favouring a persistently dominant elite may - in the sum! - shape the onset and profile of economic development.

\textsuperscript{127} Consider also the case of the two cantons of Bern and Zurich, Bern having a history of feudal landowners inclined to serve in foreign military service while in Zurich a rigid regime of guilds was at power. In the 19th century, both cantons had to overcome under the influence of the new industrial elite this heritage and knew a parallel progress. Bern started to fall back at the beginning of the 20th century, when Zurich derived e.g. full benefit from the knowledge spillovers created by the Federal Polytechnical Institute that was established in the heart of the town. In Bern, at the beginning of the 20th century, the rural elite got again access to power, privileged the preservation of agrable land over the construction of a national airport and knew in the 60’ an executive at the cantonal level of nine members of which one only cared for the forests, one for agriculture and the third for the rest of the economy. Bern also ran six agriculture schools whereas the cantonal polytechnical institutes were not promoted to university level and

\textsuperscript{128} To build on the risk that the deliberately oppressed population groups will turn to communism helped also in organising foreign support.

\textsuperscript{129} Estate owners dominated policy in Latin America since independence, the Monroe doctrine was interpreted by the US as giving the US the role as a hegemon over the continent only at the turn to the 20th century (Roosevelt corollary).
depends partly on how inequality is measured. Deininger and Olinto (2000) in their World Bank Policy Research Working Paper: Asset Distribution, Inequality, and Growth, use assets (land) rather than income to examine the relation between inequality and growth. Based on growth records over 30 years for 60 countries, they interestingly find evidence that asset inequality – but not income inequality - has a relatively large negative impact on growth. Additionally, they also find that a highly unequal distribution of assets reduces the effectiveness of educational interventions. This means that policymakers should be more concerned about households’ access to assets, and to the opportunities associated with them, than about the distribution of income, they conclude.

The importance of studying independently the impact of asset distribution inequality and income distribution inequality is immediately understood if one considers the resulting policy recommendations. If inequality of assets is the underlying factor, policies to enhance growth should emphasize ex ante equality of opportunity. The range of options includes policies that increase opportunities and incentives for creation of new physical and human capital assets, better definition, enforcement, and protection of property rights to assets held by the poor, and possibly one-time measures of redistribution. If, by contrast, income inequality causes low growth, more direct redistribution of current income or consumption might be called for.

We put the study by Deiniger and Olinto (2000) also in the centre of this section as it gives a good idea of the difficulties to test validly the causalities between determining factors and growth.

Secondly, it is interesting to see how a study devoted to inequality can yield results regarding the effectiveness of educational spending.

According to Deininger and Olinto (2000), four links between inequality and growth have been identified in the literature. A first link is political in nature. Public money is spent and collected differently according to whether the poor or the wealthy have politically more to say. If the representative voter has no fortune and low income, numerous re-distributional measures will be adopted and will curtail the incentive to work and to undertake a risky entrepreneurial activity, the argument runs. Growth risks to remain depressed. However, the alternative, namely to wield the political power to an elite, conveys also risks of a deadlock, as was argued in the section above. A second possible link, closely related to the former, is due to the consequences of inequality on social cohesion (social capital). Political instability reaching eventually the level of civil wars can be extremely detrimental for the growth process (see Chapter 12). A third link explains the inequality-growth relationship by the constraints arising on the capital market when the poor do not have appropriate collateral to finance their projects by credit (availability of credit will be the topic of Chapter 3). Finally, a fourth link can exist due to the impact of inequality on economic efficiency in a general, more diffuse sense. The Schumpeterian growth model identifies a number of coefficients relevant for the dynamics of growth, and many of them are influenced by the distribution of income and wealth in society.

Since the Schumpeterian growth model is more relevant for advanced economies, the discussion of these coefficients will only be taken up in a later chapter.


131 The authors use deliberately the term „possibly” (see below). If asset inequality is the problem, the first-right policy measure, namely to redistribute assets, may indeed create problems of its own when set in a dynamic perspective. If those holding power have confiscated fortunes once, they have a substantial problem to credibly commit that they will not do it a second and third time whenever it is politically opportune to do so. The expectation of being repeatedly deprived of the assets generated by successful undertakings can block any investments. The country ends in this case in the worst of all conceivable situations: It suffers from the possibly violent conflict over the first redistributive action and, afterwards, due to confidence lost, the expected growth process will not set in. This is the “holdup” problem as mentioned e.g. by Acemoglu (2009).

132 To get a flavour of these more diffuse links the Schumpeterian growth model is pointing to, we can mention the importance of the ratio between high and low skilled workers, access to higher education often depending on family income. We can also think of the fact that the location and steepness of the demand functions on single product markets are determined by income and wealth; how demand curves are shaped is relevant in the Schumpeterian growth model for the mark-up firms can charge and thereby for the own capital companies can invest in innovation. Finally, wealth can make it easier to absorb a financial setback. The faculty and propensity to undertake risky R&D projects may therefore also be shaped (in an indeterminante sense) by inequality.
Note that the causalities mentioned have sometimes a closer link with income and sometimes with the asset distribution. The distribution of assets and earnings between households, government, companies in traditional and in new industries is also of importance. If e.g. profits are retained and reinvested and owners of companies do not splurge with their richness, social cohesion may be preserved. And, finally, the sense of the relation is often open. When credit constraints are present, it is e.g. better when income and wealth are concentrated with those people who have the knowledge and the readiness to deploy entrepreneurial activity. In this regard, an equal distribution of income and wealth can be inferior to a distribution based on past incomes.

Theoretical relations pointing into opposite directions make it necessary to rely on empirical research when distributional measures shall not only be motivated by considerations of instantaneous equilibrium but also by considerations of economic efficiency and growth.

Deininger and Olinto (2000) first observe that due to differences in data (notably income vs. asset distribution) and methods (notably cross-sectional versus panel studies), the empirical literature has yielded ambiguous predictions regarding the presence, let alone the magnitude, of a causal link, even if this may not hold true. He has e.g. to use in the regressions instrumental variables (IV) as regressors instead of the explanatory variables themselves. Candidates for instrumental variables are in particular lagged values of the explanatory variables. In line with these considerations, Deininger and Olinto (2000) use the GMM estimator proposed by Arellano and Bover (1995). This GMM estimator is based on two sets of orthogonality conditions that must hold. The first set relies on an assumed orthogonality between \( \Delta \varepsilon \) and the predetermined variables \( y_{t-2}, y_{t-3}, \ldots, y_{t-\bar{m}}, X_{t-2}, X_{t-3}, \ldots, X_{t-\bar{n}} \). The second set relies on an assumed orthogonality between \( \Delta \varepsilon \) and the first difference of the predetermined variables, i.e., \( \Delta y_{t-1}, \Delta y_{t-2}, \Delta y_{t-3}, \ldots, \Delta y_{t-\bar{n}}, \Delta X_{t-1}, \Delta X_{t-2}, \Delta X_{t-3}, \ldots, \Delta X_{t-\bar{n}} \). In addition, orthogonality between \( \Delta \varepsilon \) and the strictly exogenous components of \( Z \), has to prevail in order to obtain consistent estimates of the sign and magnitude of the causal link. This does not necessarily hold true.

Estimation based on ordinary least squares (OLSQ) would result in biased and inconsistent results. To apply OLSQ, the researcher has to feel sure that the explanatory variables \( X_{t-1} \) and \( Z \) are not correlated with \( \varepsilon_t \). If he feels that this may not hold true he has e.g. to use in the regressions instrumental variables (IV) as regressors instead of the explanatory variables themselves. Candidates for instrumental variables are in particular lagged values of the explanatory variables. In line with these considerations, Deininger and Olinto (2000) use the GMM estimator proposed by Arellano and Bover (1995). This GMM estimator is based on two sets of orthogonality conditions that must hold. The first set relies on an assumed orthogonality between \( \Delta \varepsilon \) and the predetermined variables \( y_{t-2}, y_{t-3}, \ldots, y_{t-\bar{m}}, X_{t-2}, X_{t-3}, \ldots, X_{t-\bar{n}} \). The second set relies on an assumed orthogonality between \( \Delta \varepsilon \) and the first difference of the predetermined variables, i.e., \( \Delta y_{t-1}, \Delta y_{t-2}, \Delta y_{t-3}, \ldots, \Delta y_{t-\bar{n}}, \Delta X_{t-1}, \Delta X_{t-2}, \Delta X_{t-3}, \ldots, \Delta X_{t-\bar{n}} \). In addition, orthogonality between \( \Delta \varepsilon \) and the strictly exogenous components of \( Z \), has to prevail in order to obtain consistent estimates of the sign and magnitude of the causal link. This does not necessarily hold true.

\[ (y_{t} - y_{t-1}) = \delta y_{t-1} + \beta' X_{t-1} + \gamma' Z_{t} + \varepsilon_t \]

where \( y_t \) denotes the logarithm of per-capita GDP of country \( i \) observed in period \( t \), \( X_{t-1} \) is a vector of country-specific time-varying variables affecting growth, and \( Z \) is a vector of country-specific time-invariant variables that also affect GDP growth, while \( \varepsilon_t \) is an error term that captures the effects of time-invariant and time-varying unobserved country characteristics \( (\varepsilon_t = U_i + \varepsilon_\delta) \). While \( \delta \) is a scalar parameter, \( \beta \) and \( \gamma \) are parameter vectors.

133 Theoretically, poor people can have an interest in leaving a high income with entrepreneurs if the latter’s investments render the supply of the skills the poor can offer on the labour market scarce. Improved wages increase future consumption and possibly life time utility. The reflection requires that poor people can cover basic needs with the income left to them and a low rate of time preference. This does not necessarily hold true.

134 Remember that in Ordinary Least Squares (OLSQ), the explanatory variable(s) act as regressor(s), i.e. the left-hand variable, the explanatory variable(s) and the error terms are multiplied by the explanatory variable(s). To obtain consistent estimates, the expected value of the product of the explanatory variable(s) and the error term has/have to be zero. Otherwise, they should be replaced by instrumental variables as regressors. Past values of the explanatory variable(s) qualify as such, because normally, past values cannot impact on current errors provided the lag-structure has appropriately been taken into account when choosing the number of lags of the instrumental variable, and provided that the error is not autocorrelated, the latter typically accruing due to omitted explanatory variables. Furthermore, lagged variables are usually highly correlated with current explanatory variables so that the loss in efficiency in the estimates is not suffering too much by switching from OLSQ to IV. Lagged explanatory variables are not the only candidates as instrumental variables and different tests allow to appreciate their suitability.

135 Arellano M. and O. Bover (1995); Another Look at the Instrumental Variables Estimation of Error Components models, Journal of Econometrics 68 (1)
strength of the effect the explanatory variables exert on growth.\textsuperscript{136}

Empirical work not only has to have recourse to sophisticated estimation techniques as just described. The problems posed by finding appropriate data is of equal importance. The data problem is particularly acute here since the study concentrates on effects of inequality in a developing country context. For developing countries, only few data are recorded. The data for the major variable of interest, the initial distribution of (operational) holdings of agricultural land, was assembled from the decennial FAO World Census of Agriculture. The authors complement this measure of inequality with measures of real GDP per capita and the share of investment in GDP as well as with data on the per capita human capital stock. Time-varying variables used in the regressions (i.e. the country-specific series making up the data matrix X) are per capita GDP, the income Gini coefficients and the measure of country and year specific educational stock. One time-invariant variable is included, namely the country Gini coefficients for the initial (1960-1970) land ownership distribution, but these values are considered to be endogenous (i.e. among the variables to be explained, together with the country growth performances for the six 5-year periods 1960-65, 1965-70, 1970-75, 1975-80, 1980-85 and 1985-90). \(Z_t\) thus reduces to a vector of one’s and fulfils the role of a constant shared by all country regressions.

Estimating the equation indicated above in reduced form, Deininger and Olinto (2000) find evidence for a negative impact of land inequality, and a positive and significant coefficient for education on growth. The coefficient of the land Gini as an explanatory variable for four future 5-year growth periods is not only highly significant but also comparatively large. The positive coefficient of education on growth is in contrast to many empirical studies. The authors argue that their result is in line with those other studies where human capital is measured by an adequate stock measure.\textsuperscript{137} In a second step, they allow for the fact that the impact of education varies across countries depending on the income level they have reached. When including an interaction term of education with the GDP-level, the results obtained suggest that there is actually absence of convergence in GDP per capita levels for all countries below a minimum level of human capital stock (with a point estimate of about 6 years of schooling).\textsuperscript{138} The negative sign of the coefficient on the interaction between education and income is pointing towards greater effectiveness of additional investment in education in poor countries. Land ownership inequality remains negative and significantly different from zero in this second estimation. Adding, in a third estimation, an interaction term between education and asset inequality suggests that high inequality of asset ownership reduces the effectiveness of policies that aim to increase aggregate growth through investment in education. It thus appears that asset inequality is linked to development also through educational efforts and not only through capital market imperfections (i.e. the poor obtain no credit to acquire or rent land or equipment to work the land). Inclusion, in a fourth estimation, of the income Gini into the reduced form equation confirms a positive effect of education, a negative impact of the interaction between education and income, and a significant growth-reducing impact of asset inequality. In line with what was found in other contributions to the literature, the coefficient on income inequality is positive and significant in two of three equations retaining respectively other sets of explanatory variables. Income inequality, when a separate impact of land ownership inequality is included in the estimation, therefore appears to favour growth. This effect appears to persist after levels of investment in physical capital are controlled for. In this last specification of the equation the authors tested, lagged investment and the economy’s human capital stock appear as highly significant determinants of growth. Again, the land Gini is significant and negative if included on its own or in interaction with human capital.

Overall, the negative impact of an uneven asset distribution on development appears to be a robust finding whereas the link of income inequality

\textsuperscript{136} Expressed in words, the first orthogonality condition requires that the change in the error term referring to country i between t-1 and t (\(\Delta e_t\)) is not correlated with the country-specific variables (y and X) prior and up to period t-2. The second condition stipulates a similar requirement for the relation between the error in t and changes in the country-specific variables up to period t-1. Finally, the time-invariant explanatory variables referring to country i should not be influenced by the variables the model seeks to explain.

\textsuperscript{137} The enrolment rate in primary school as a percentage of the population in age class 5-20 — an often used explanatory variable - tells little on the human capital stock currently present in an economy when large shares of the adult population had had no opportunity to go to school. Current enrolment rates are too much forward looking.

\textsuperscript{138} This point of a minimum of years of schooling securing convergence of GDP will be taken up in Chapter 8.
to growth is less certain.\textsuperscript{139} As appropriate estimation techniques require to test simultaneously for the impact of other relevant explanatory variables, interesting results regarding the nexus of education and development emerge.

2.3 Land redistribution not necessarily at the heart of land policy

Mainly written by Klaus Deininger, the first author of the paper we put in the centre of the preceding section, the World Bank released in 2003 a report on land policy for growth and poverty reduction.\textsuperscript{140} The report addresses a number of aspects that go along with the allocation and exercise of property rights on land. Perhaps surprisingly, land reform in the sense of land redistribution is seen with considerable reservation and attention is drawn to numerous other regulations that affect the utilization of land which may be optimised in the interest of growth and the poor. The following paragraphs are excerpts out of the executive summary of this report counting some three hundred pages. Shaped by the views of the author of this book, this selection of texts and the added subtitles may not do justice to the original report.

Problematic land ownership structures in all major world regions

Given that the historical evolution of property rights is not only a response to purely economic forces, it is not surprising that the arrangements found in many countries are often not optimal from either an economic or a social perspective. For example, in Africa, the vast majority of the land area is operated under customary tenure arrangements that, until very recently, were not even recognized by the state and therefore remained outside the realm of the law. In Eastern Europe, collective production structures have failed to contribute to rural growth. In Latin America and part of Asia, highly unequal land ownership and access to assets have made it difficult to establish inclusive patterns of growth.

Advantages of well-defined and enforceable property rights

There is concern when property rights are poorly defined or cannot be enforced at low cost. Conflicts historically often erupt first in conjunction with land transfers, especially to outsiders. Individuals and entrepreneurs will then be compelled to spend valuable resources on defending their land, thereby diverting effort from other purposes such as investment. Secure land tenure also facilitates the transfer of land at low cost through rentals and sales, improving the allocation of land while at the same time supporting the development of financial markets. Giving secure property rights to land they already possess can greatly increase the net wealth of poor people. Control of land is particularly important for women, whose asset ownership has been shown to affect spending, for instance, on girls’ education. Yet, traditionally, women have been disadvantaged in terms of access to land ownership. Over and above the economic benefits that may be derived from giving households greater tenure security, measures to increase households’ and individuals’ ability to control land will have a clear impact on empowering them, giving them greater voice, and creating the basis for more democratic and participatory local development.

State ownership of land and how land may be transferred

In many countries, the state continues to own a large portion of valuable land despite evidence that this is conducive to mismanagement, underutilization of resources, and corruption. Also, land in public or unknown possession is often subject to squatter. Corresponding property rights are regularly not enforced over years because of the evident need to offer accommodation to a growing population and high potential of conflict. The report states that in such circumstances, the recognition of long-term, peaceful occupation in good faith (adverse possession) and the award of long-term land leases with provisions for automatic renewal will be the most desirable option. However, if leases awarded by state institutions are not credible, measures to increase tenure security or, alternatively, full privatization, will be required to give users sufficient security of tenure and the associated benefits. An indicator pointing to a limited credibility of leases is a situation where financial institutions will not accept long-term leases as collateral even when there is a strong, effective demand for credit.

A well-designed legislation for land rental conveys benefits to all

Most South Asian countries have legislation restricting land rentals to avoid exploitation of tenants by landlords. This is delicate since, because of lower capital requirements, many producers prefer to rent rather than to buy land. The fact that


well-functioning, though often strongly regulated, rental markets in most industrial countries exist and allow households to enter into long-term contracts that do not appear to be associated with a visible reduction of investment incentives, demonstrates the flexibility and possible advantages of land rental.

Inheritance legislation matters

High levels of fragmentation, caused either by successive sub-division in the course of inheritance or by the desire to award at least one plot of a specific quality or use type of land to each producer in the process of land distribution, are often thought to lead to inefficiencies in agricultural production. Although significant monetary and nonmonetary benefits are reported from Western Europe, programs to consolidate dispersed ownership of lots into contingent properties have often been costly and slow.

Substantive conditionality for land reform

The fact that in many countries the current land ownership distribution has its origins in discriminatory policies rather than in market forces has long provided a justification for adopting policies aimed at land reform. The record of such policies is mixed. Where extreme inequality in land distribution and underutilisation of vast tracts of productive land co-exist with deep rural poverty, a case for redistributive measures to increase access to land by the poor can be made, both politically and from an economic perspective. Those benefiting from land reform need to be able to access output markets as well as credit, the selection of beneficiaries needs to be transparent and participatory, and attention needs to be paid to the fiscal viability of land reform efforts.

Land taxation is a valuable instrument

Land taxes have long been identified as a source of own revenue for local governments that is associated with minimal distortions. The high visibility of land taxes implies that establishing them may be difficult politically, especially in settings where landlords still wield considerable political power. To tax land and not the products of the land may create an incentive to cultivate idle grounds.

Measures to protect broader social and cultural values need to be well-calibrated

There is a clear role for government to ensure that resources will not be irreversibly destroyed by myopic individual actions when they embody broader social and cultural values and benefits, such as landscapes, biodiversity, historic sites, and cultural values. Expropriation in the public interest can be an option to preserve such values. However, the report notes, the way in which many developing country governments exercise this right, especially for urban expansion, undermines tenure security and, because often little or no compensation is paid, has also negative impacts on equity and transparency. Zoning and other land use regulations - a substitute to expropriation - should also be established based on a clear assessment of the capacity needed to implement them, the costs of doing so, and the way in which both costs and benefits will be distributed.

2.4 Considerations regarding FDI

In principle, policies regarding access to assets and conditions for their exploitation are in the realm of national policies. Any link to globalisation is indirect in nature. These indirect links may be of considerable importance, however. In particular, the preconditions identified for a growth deadlock matter. A potential symbiosis of a landed elite with (high touch) consumer good exporters in industrialised countries can be identified as a possible source of such a deadlock.

Importantly, however, foreign companies can be affected in different ways by the policies adopted domestically. As exporters, particularly of high touch goods, companies can profit from a landed elite opening up their markets for imports of consumer goods. But as an exporter of investment goods, one can have no interest in seeing a growth deadlock emerge in target markets out of the policies of a landed elite intended to hold back domestic manufacturing. A third category are foreign companies interested in producing domestically. These are better placed when trade is opened and joint ventures are sought by local producers in order to acquire technology and to withstand competition on the domestic or globalised markets than in the case where they have to proceed to FDI in order to undercut tariff protection as the only way to get access to a local market. In the latter case, reflecting a strong bias towards nationalist policies, the benefit of tariff protection for their subsidiaries may be limited in time since the risk of expropriation whenever the venture turns profitable is marked. Tariff protection is also complicating the distribution of tasks within the company and the exploitation of economies of scale in production and commercialisation.

A consequence of the preceding reflections is that host countries may have accepted foreign subsidiaries for different reasons. Often, they may have cut back their presence to the simple role of a local sales representative. In other cases, a significant foreign investment in production facilities may have taken place due to capital shortage in the host country or due to a lack of know-how in the host country in certain industries. Since the host country is defining the roles
foreign companies may assume, to negotiate access for FDI is different from negotiating protection of FDI that has already occurred. Only in the latter case we have a coincidence of interests and this only for a limited time. More precisely: Once a host country has identified the kind of foreign presence in domestic markets it is interested in, it has also an interest to make sure that such presence is effectively established. This will not occur when the government in place cannot credibly commit that a next government will refrain from looting the foreign investors. Given this interest of host countries, not surprisingly, bilateral investment protection agreements are widespread whereas attempts to negotiate market access guarantees for FDI have failed. We refer here to the Multilateral Investment Agreement (MIA) which was discussed in the OECD in 1996 to 1998 but ran aground and to the defeat proponents of market access guarantees for FDI suffered at the WTO Ministerial Conference in Seattle in 1999 when an attempt was made to transfer part of the MIA in the WTO framework.

Part III

Investment Protection Agreements

3.1 Main features of IPAs

For a host country, FDI is an opportunity to bring foreign capital and knowledge into the country. But there is a considerable risk for the investor of being looted once he has made the investment. Most spending is irreversible and even when the investment can be sold (at a (presumably) depressed price) no guarantee exists that the money can be taken out of the country. This is to say that recipient countries have to solve the problem of credibly committing. A credible commitment guarantees enforcement of well-established property rights outside the country’s boundaries in the case of undue appropriation or annihilation of the investment by future government acts. Such enforcement possibilities can not only be laid down in contracts the investor concludes directly with the host state, but also in treaties between the home state of the investor and the host state. For the home country, such treaties enhance the effectiveness of diplomatic protection. Since the focus of these agreements is not on market access but on investor protection, investment agreements are commonly also denominated as investment protection agreements.

A first Bilateral Investment Treaty (BIT) was concluded in 1959 and their number increased in the following years, driven by the fear of an expansion of Soviet communism beyond its post-WWII boundaries and by decolonisation, the new governments often favouring centrally planned approaches to steering the economy. Starting in the 90’s, the number of BITs exploded, an evolution for which three reasons can be advanced: First, major global economic institutions such as the OECD and the UNCTAD began to push for them, considering FDI and its promotion an engine for growth. A second factor was conditioning the insurance for private investments into developing states on the presence of an investment treaty covering that investment. For instance, the International Finance Corporation (IFC), the private financing arm of the World Bank, sees BITs as an important risk management tool. A third factor behind the proliferation of investment treaties is the overall growth in FDI, making them more relevant.

Most investment treaties are bilateral, their number actually exceeds 3400 agreements but some investment treaties take the form of regional investment treaties. Examples are the treaties covering the countries in the Common Market for Eastern and Southern Africa (COMESA) and the Association of Southeast Asian Nations (ASEAN). Jurisdiction over the provisions contained in the North American Free Trade Agreement (NAFTA) has gained prominence. Furthermore, bilateral Free Trade Agreements of the 2nd generation regularly contain a chapter on investment. The latter do not directly compare to BITs, however. While BITs focus on providing protection to FDI that has already taken place in the host countries, investment chapters in FTA focus on opening up and guaranteeing FDI opportunities in the participating countries. Both forms of treaties may contain both elements, however.

The idea of multi-lateralising this network of bilateral treaties is straightforward, but never succeeded. Interested governments launched in

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141 The text of sections 3.1 and 3.2 is an excerpt from: Bernasconi-Osterwalder, Nathalie and Aaron Cosbey and Lise Kohnson and Damon Vis-Dunbar (2012): Investment Treaties & Why they Matter for Sustainable Development, published by the International Institute for Sustainable Development, Winnipeg, with the support of the Swiss Agency for Development and Cooperation (SDC).

May 1995 within the OECD negotiations on a proposed Multilateral Investment Agreement (MIA) with the idea that the other countries would later join the agreement, but the negotiations broke down in 1997 under the pressure of NGOs. In 1996, WTO member-countries decided at the Singapore Ministerial Conference to set up three new working groups, including one on investment, but the idea remained contested, also by developing countries, so that during the 2003 ministerial conference in Cancún, Mexico, the issue was dropped from the Doha agenda.

The "model" BITs used by many countries today are markedly different from those they used 20 years ago, but usually the following eight categories of provisions are present:

- Fair and equitable treatment (FET);
- Compensation in the case of direct or indirect expropriation;
- National treatment, or treatment no less favourable than that given to domestic investors;
- Most-favoured nation (MFN) treatment, or treatment no less favourable than that given to investors from third countries;
- Freedom from so-called "performance requirements" as a condition of entry or operation. These are requirements, for example, to transfer technology, to export a certain percentage of production, to purchase inputs domestically, or to undertake research and development locally;
- Free transfer of capital;
- A blanket obligation, known as an "umbrella clause," which obliges the host state to respect any legal or contractual obligations it may have to the investor;
- The right to bring arbitration claims against host governments.

The paragraphs that follow will examine the first seven provisions in more details. The eighth and final point needs further subdivision and will be the topic of section 3.2.

The fair and equitable treatment clause: The FET-clause has in numerous cases allowed investors to succeed where their expropriation, non-discrimination and other claims have failed. It has thus become a kind of "catch-all" clause. Host states have, for example, been found to violate it for a failure to act in a transparent manner in administrative decision making. Other violations have been found in the inconsistent actions of host state agencies vis-à-vis the investor, such as the encouragement and approval of the investment by one agency and the denial of the necessary zoning permits by another. One solution to the vagueness what FET comprises would be to require only that the host government does not behave in a manner that is egregious and shocking, another solution might be that investors' expectations must be reasonable and legitimate in light of the circumstances prevailing in the host country. Clearly, host governments should always be transparent and act consistently, but the reality is that they are not always proceeding so, particularly when more than one agency or level of government is involved. Coordination among ministries and different levels of government is difficult even for developed countries, making a standard of freedom from ambiguity and total transparency seem unrealistic for any country. A favourable result of a FET-provision may be that states will proactively improve their regulation and administration with respect to investors. But in a dynamically evolving environment, regulatory change becomes through such provisions and the use made of them in arbitration a gamble. The author of the handbook from which these indications are taken suggests an interpretative note, indicating that the FET requirement is synonymous with the customary international law minimum standard of treatment of aliens. Basic requirements are that expropriation is for a public purpose; non-discriminatory (that is, not targeted at a specific company or nationality); and in accordance with the due process of law. Explicit guarantees by the host government that it will not take the measures in question deserve also protection, an aspect relevant in cases of indirect expropriation.

The inclusion of indirect expropriation: Expropriation is generally described as falling into two categories: direct and indirect. Can measures taken for a clear public purpose, such as public health or environmental protection, constitute an indirect expropriation? The cases decided to date do not provide a clear answer. The outcome depends on the facts of the case, as well as the test applied by the particular tribunal evaluating it. There are three competing principles:

- the "sole effects doctrine": If legal change causes a write-down on the investment, an indemnity is due, irrespective of the nature of the legal change,
- proportionality: Legal changes may cause a certain depreciation of the investment, but the loss incurred has to be justified by a substantive improvement of the public good the legislation pursues,
- the "police powers" carve-out: The host state is free to legislate in the area of basic security provisions ("police goods"), such as the protection of life, health and the environment. Such legislation can not constitute an
indirect expropriation and is carved out from the application of the treaty.

A problem with indirect expropriation is that arbitrators are not obliged to follow any one, or indeed any, precedent, often delivering awards that seem to be at odds with previous decisions. The legal uncertainty reigning today is problematic for both the host state and the investor. As a response, an increasing number of states are incorporating additional language in their investment treaties clarifying the scope of indirect expropriation. However, depending on the specific circumstances, an arbitration panel may not be wrong when it concludes that the reasoning behind an act amounting economically to indirect expropriation was not adopted due to e.g. environmental concerns, but rather that the government measures were taken to appease local protestors.

Treatment no less favourable than that given to domestic investors: The more finely a tribunal identifies differences and draws distinctions between domestic and foreign investors, the less likely it will be that it will find a domestic investor has been treated differently than the foreign investor. It makes e.g. a distinction whether adherence to a certain industry or the utilisation of a certain technology serves as the distinguishing criterion. National treatment rights at the pre-establishment stage entail particularly significant commitments, and are seldom offered across the board. Rather, as with the GATS and some investment chapters in FTAs, states that offer these rights will often do so only in certain identified sectors (the list-in or positive list approach), or they will specify a list of sectors, activities, and/or policy areas in which the commitments do not apply (the opt-out or negative list approach).

The MFN clause: There is an ongoing debate on whether and to what extent it should be possible to use the MFN clause in BITs to import favourable provisions from other treaties signed by the host state. Could an investor, e.g., import obligations from agreements other than BITs? Could it complain that a host country had caused it harm by actions that violated commitments under the WTO’s GATS, TRIM or TRIPS agreements? The drafters of those agreements never intended to grant private investors the right to enforce those treaties’ provisions through binding arbitration initiated by private parties. And how about the WTO agreement on Government Procurement, which is clearly not an investment agreement?

Performance requirements: Apart from reference to the TRIM agreement, the majority of investment treaties do not mention performance requirements. However, the United States and Canadian agreements do so since the NAFTA contains them, as do agreements concluded by some Asian countries. The European Commission might negotiate rules to limit the use of performance requirements in its future investment treaties or chapters. Note that the TRIM agreement does not permit investors to bring themselves measures like performance requirements to arbitration. Economic theory cannot show that performance requirements are a bad policy for the host country. Spending on research and development (closely correlated with the capacity of innovation) is typically higher in head office states than in subsidiaries. Arguably, the greatest downside of the infant industry approach is the risk that the infants will never “grow up” and the economy will be indefinitely saddled with inefficient low-quality producers.

Free transfer of capital: Multinational enterprises function to some extent also as banks. They have to finance the own capital needed for new FDI by cash flows taken out of existing investments, and they actively manage exposure to exchange rate risks and the like. The withdrawal of funds should however not occur in contradiction of the ‘ordre public’ of the host state. The host state usually reserves the right to enforce laws relating to (1) bankruptcy and the protection of creditors’ rights, (2) issuing, trading, or dealing in securities, (3) enforcement or collection of fines and judgments, and (4) financial reporting. Some also contain safeguard or other provisions allowing states to take measures to prevent or respond to balance of payments or other general macroeconomic crisis, provisions that are more difficult to accept from the point of view of an honest investor. However, EU member states have been called by the European Court of Justice to review and re-negotiate the sweeping free transfer clauses contained in their BITs. According to the court, this is necessary in order to bring the agreements into compliance with European law, which demands more flexibilities in times of financial and macro-economic crises.

The umbrella clause: The umbrella clause in the US-Argentina BIT of 1994 reads: “Each Party shall observe any obligation it may have entered into with regard to investments.” Such a clause could make enforceable any provisions the host state has entered to with respect to investment, e.g. GATS obligations. Not all courts finished by giving to such an encompassing clause a narrower meaning, for example, that it makes the actual contracts between host states and foreign investors enforceable. With this limited scope, the umbrella clause may become particularly potent when combined with an investor–state contract that features a stabilization clause. Stabilization clauses are clauses that promise to insulate the investor from changes in the host state’s laws, and they typically figure in capital-intensive, site-specific, long-lived investments such as projects
in the extractive industries. On expropriation, for example, stabilization clauses may completely moot the police powers carve-out described above. It has to be noted that stabilization clauses may alter the nature of the commitment to FET as well. An important component of FET in many of the arbitration rulings is the requirement that the host state respects the “legitimate expectations” of the investor when it decided to invest. While umbrella clauses are frequent in BITs, the fact is that almost exclusively developing countries sign contracts with investors including stabilization clauses.

The notion of investment: Contracting parties may finally have an interest to clarify what may potentially qualify as an investment. For example, states have excluded from the scope of covered “investments” such items as debt securities issued by a government; portfolio investments; or claims to money that arise solely from commercial contracts for the sale of goods or services. Special provisions may also ensure that investments made through bribery, fraud or corruption, or investments not approved by the host country do not benefit from the treaty. Some states have also shifted towards an enterprise-based definition. As it can be simple for a foreign entity to create a formal presence in the home state for the purpose of seeking the protection of an investment treaty, some treaties also require that companies have sufficiently substantial business activities in the home state.

Typically, an investment treaty provides that it will stay in force for a given period of time, often 10 or 15 years. Usually, it will continue to stay in force until either party gives written notice of termination. However, for existing investments, the provisions of the agreement will continue in effect for another given period after denial.

3.2 The Investor-State Dispute Settlement Mechanism

Entitlement to initiate an arbitration procedure: Bilateral Investment Treaties allow for a State to State dispute settlement, but additionally also often for an arbitration between the investor and the host state. Over the last two decades, investors have increasingly used the investor–state arbitration process included in most investment treaties, a process unique in international law that allows private investors to take host state governments directly to international arbitration, without the support or even knowledge of their home state. Also, investors are allowed to proceed directly to international arbitration, without exhausting possibilities to bring the case to national courts, unless the treaty provides otherwise. Investors have challenged a broad range of government measures as allegedly violating the investment treaties and harming the investors’ rights. For sure, they also use the threat of such arbitrations without necessarily disclosing it.

Institutions and rules supporting the arbitration procedure: Most treaties provide a choice between the rules developed under the auspices of the World Bank’s International Centre for Settlement of Investment Disputes (ICSID), or those developed by the United Nations Commission on International Trade Law (UNCITRAL), the UN body responsible for international business law. Sometimes additional options are offered, such as the arbitration rules of the arbitration facilities of the Stockholm Chamber of Commerce (SCC) or the International Chamber of Commerce (ICC). ICSID was established in 1965 under the convention on the settlement of investment disputes between states and Nationals of other states (the ICSID convention) which has been signed by over 140 states. ICSID’s caseload has expanded significantly in the last decade; 166 claims were registered with ICSID during 1995–2005, compared with 30 cases in the 30 years prior. Today ICSID is by far the most commonly used arbitration facility for investor-state arbitrations. It is also the most visible, in part because of its popularity but also because it maintains a publicly accessible list of pending cases.

Forum shopping: Investors have been allowed to claim breaches of a contract in local courts, and breaches of an investment treaty in international arbitration, even when the same fundamental complaints lie at the heart of both claims. “Fork-in-the-road” provisions allow investors to weigh their options and choose whether to pursue their claims in domestic courts or through investor–state arbitration, but require that once an investor has elected one route, the other is closed off.

Appointment of the arbitrators: It is common for lawyers to move between the roles of arbitrator and counsel. One solution to the emerging problem with the impartiality of the judge (an arbitrator will, willingly or unwillingly, consider what positions he defends in his parallel activity as counsel) is a roster of permanent arbitrators, under tenure for a given number of years, which would also help insulate arbitrators from economic and political pressures.

Awards: The claims for relief can be broken down into five general categories: (1) monetary compensation; (2) restitution or return of property; (3) punitive damages (i.e., an assessment of damages against the state designed not to compensate the investor for harms suffered, but to punish the state for wrongful conduct); (4) declaratory relief (i.e., a declaration deciding a particular issue in dispute); and (5) injunctive relief (i.e., an order
telling the government to take, or refrain from taking certain action). With the exception of punitive damages, which are generally said not to be allowed in investor-state arbitrations, or only allowed in “exceptional circumstances,” investors have been successful in securing all other forms of relief. Requiring and awarding injunctive relief is particularly problematic as in this case the alleged limitation of the legislator in its decisions becomes a reality.

**Enforcement:** Two international treaties give arbitral awards this force. The first is the 1958 convention on the recognition and enforcement of foreign arbitral awards (the “New York Convention”); the second is the 1965 ICSID convention. The New York Convention requires its roughly 150 state parties to recognize and enforce foreign arbitral awards. It provides that states may only refuse to do so on seven limited grounds. UNCITRAL allows for the establishment of an “annulment committee,” but these committees can only annul an award on five grounds. A centralized mechanism for appeal, such as exists for international trade law disputes under the auspices of the WTO, would be welcome.

**Transparency:** Access of the public is limited. If one of the disputing parties wishes, e.g., the hearings must be closed. The only guaranteed disclosure will come from the ICSID secretariat, which, pursuant to a 2006 revision of the ICSID arbitration rules, is required to publish excerpts of the tribunal’s legal reasoning behind the award. Under the 1976 and 2010 UNCITRAL arbitration rules, disclosure is even more limited since both parties have to agree (this point was under revision in 2011).

**Third parties:** Submissions by third parties acting as ‘Amici curiae’ can play an important role in investment treaty arbitration. They can provide expertise on points of law, offer historical and cultural context to a dispute, and reveal how a particular dispute has wider ramifications beyond the interests of the disputing parties. Investment treaties and arbitration rules give the tribunals the authority to permit amicus curiae submissions.

**Balance of rights and obligations:** Overall however, tribunals do not appear to be considering investors’ compliance with domestic environmental, labour, or tax law after the investment is established. Several observers would have the treaties go further and suggest imposing binding obligations on investors under the agreements, including obligations on corruption, environmental impact assessments and management, and labour and human rights issues.

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143 Source: Press releases by Holcim Ltd. (http://www.holcim.com/media-relations.html)

144 Source: Entries on Wikipedia, keywords Venezuela and Hugo Chávez, as of August 11th 2014.
The dispute

On 8 April 2008, Holcim Ltd released a statement, saying that Holcim Venezuela had been officially informed by the Venezuelan government of its plans to nationalize all foreign cement producers operating in the country. Holcim had been active in Venezuela since 1978, successively increasing its stake in the country. By 2007, Holcim Venezuela operated two cement plants. At the request of the Venezuelan government, they had exclusively been producing for the domestic market for a considerable time. Holcim Venezuela, with its 774-strong workforce recorded net sales of approximately US-$200mio, accounting for approximately 1 percent of Group turnover, and had regularly been investing in efficiency improvements and environmental measures. On 18 August 2008, a basic agreement was signed, stipulating that the State of Venezuela will purchase 85 percent of Holcim Venezuela and the Holcim Group will keep a stake of 15 percent. The two parties also reached an agreement in principle on the compensation, subject to a financial due diligence. In the media release for the business year 2008 of 4 March 2009, Holcim then reported, under the heading of post-balance sheet events, that the state had taken control of Holcim Venezuela. It added that the payment of the compensation of US-$550mio as agreed in a Memorandum of Understanding with Petróleos de Venezuela S.A. (PDVSA), acting on behalf of the Venezuelan Government, was still due. Holcim stated its determination to safeguard the interests of Holcim and its local employees in accordance with the bilateral investment protection agreements in place between Switzerland and Venezuela, dated 18 November 1993, and declared that the company would appeal to the International Center for Settlement of Investment Disputes in Washington. Demanding full compensation, Holcim said on 31 July 2009, that it had to date not received a compensation offer from the Republic of Venezuela that is acceptable from a legal or financial standpoint, and that it will continue with the arbitration proceedings as filed with the ICSID. On 13 September 2010, Holcim signed a settlement with the Bolivarian Republic of Venezuela agreeing on a compensation payment of US-$650mio and the suspension of the international arbitration procedure pending before ICSID. A first down-

3.3 A critical assessment

As set out in Chapter 6, there are multiple motives to engage in FDI. The presence or absence of a BIT is not a ‘sine qua non’ for FDI flows to occur, rather their impact must be studied within the context of the political, economic and institutional features of the host country that is signing the BIT and in light of the worldwide BITs regime. While part of the available empirical studies conclude that those developing countries that have signed more BITs with major capital exporting developed countries are likely to have received more FDI in return (e.g. Neumayer and Spess (2005))145, other studies came up with counter-intuitive results or raised questions regarding whether investment treaties actually cause an increase in investment flow or whether other concomitant factors, such as broader changes in economic policy, are responsible for the result. In a study of 2011, Mudziviri Nziramasanga, Frederick S. Inaba and Sanatan Shreay from the Washington State University146 extend the analyses in interesting directions. Based on a panel including 143 developing countries and the data period 1961-2006, the authors observe first that after an initial positive impact of concluding a BIT, FDI tended to stagnate or even receded. Theoretically, they explain this pattern as follows: While giving the investor the right to have disputes with the host country arbitrated by international panels is key to the credibility of the host country’s commitment to the BIT, the BIT-constrained host country, nevertheless, retains wide policy flexibility as a sovereign nation, and still may choose to abrogate specific obligations made to foreign investors when the country’s interests dictate so. The dispute itself then lowers the perceived credibility of the host country’s commitment and thereby mitigates some of the BIT’s influence to attract FDI. They see their empirical analysis of the determinants of FDI flows to developing countries in accordance with the mechanism described. Specifically, they find that BITs are significant in attracting FDI flows and that disputes tend to have a significant negative effect on FDI flows. Investment is primarily discouraged through periods of economic contrac-


tion relative to the source country, periods of rela-
tive expansion not exercising a comparable positive impact. Finally, a relatively large volume of intermediate goods imports indicates some restraint by the host country from discriminating against foreign economic activities (by imposing e.g. domestic content provisions), and thereby enhances the prospects for foreign investments. They conclude that while BITs serve as temporary, if imperfect, substitutes for institutional protections, they do not obviate the need for credible reforms to establish domestic institutions that create a predictable economic environment.

While one may therefore conclude that BITs fulfill their purpose, one has also to accept that the current agreements and relevant institutions lack some of the basic characteristics one would expect from a good regime of governance, including predictability of results, certainty about commitments, balance between treatment of investment and other public goods, presence of impartiality, transparency and openness. The most important message of the handbook we resume here is that there are viable options for addressing at least some of the problems raised by the current system: “None of them is overly complex, none is pioneering in the sense that they have not been used successfully in other contexts, but all require a good measure of political will.”

In particular, critical observers make the point that by the ISDSM, a small group of arbitrators reviews decisions democratically taken by a vast majority. There is however nothing extraordinary in this fact. International treaties often allow for arbitration, and within national borders, constitutional courts exist in many countries and are given the power to review at least the decisions of regional entities. Even where new legislation may not be reviewed by such courts, economic agents are often given a chance to seek redress for an undue and disproportionate loss. This may even be the case when the latter is not due to decisions specifically addressed to the agent in question, but due to a new law (a law being by definition addressed to an unspecified number of judicial and natural persons). This is to say that in order to obtain compensation, expropriation does not need to be formal; to deprive an owner of the substantive benefits of his property is regularly assimilated to a formal expropriation. When the criteria for substantive expropriation are fulfilled will usually be decided on a case by case basis. Provided the redress is in form of a cash amount, it is wrong to argue that the legislator is restrained in his ability to decide on new legislation by the ISDSM, but eventually legal change comes at extra costs to him; there may be a chilling effect. However, whether these costs are indeed disproportionate, if not prohibitive has to be assessed against the benefits obtained by the country thanks to having been able to credibly commit not to expropriate investors without due compensation. Finally, it goes without saying that prior governments may restrict later political decisions by signing international treaties. Abrogation clauses are standard in such treaties and allow for future political developments. Venezuela, e.g., has put a term to its BITs (but pays currently also one of the highest risks spreads on government bonds, although the latter is a reflection of the dismal general investment climate of which the abrogation of BITs is only an expression).

On the other hand, not any legal change that has unfavourable financial consequences for an economic agent can and should be assimilated to substantive expropriation. A number of decisions taken by arbitration based on the ISDSM comes, however, close to compensate for legal change as such. ¹⁴⁷ Expressed differently, companies may have received money for amendments in legislations they would have had to accept without any chance of redress in their home country, even if the latter is a privileged place for foreign investment. According to a ruling ¹⁴⁸ by the Fed-

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¹⁴⁷ The EU Commission (source see below) points e.g. to the ruling in the litigation about tobacco advertising legislation between Philipp Morris and Australia.

¹⁴⁸ BGE 131 II 728 ff., 730 ff. E.2: „Eine materielle Enteignung... liegt vor, wenn das Eigentum der bisherige oder ein voraussehbar künftiger Gebrauch einer Sache untersagt oder in einer Weise eingeschränkt wird, die besonders schwer wiegt, weil der betroffenen Person eine wesentliche aus dem Eigentum fließende Befugnis entzogen wird. Geht der Eingriff weniger weit, so wird gleichwohl eine materielle Enteignung angenommen, falls ein-
As we will see in the next section, negotiations among two major trading blocks may in due time set new standards by which these deficiencies will be overcome.

3.4 The ISDSM in the proposed TTIP

In June 2013, the European Council asked the European Commission to start negotiating a free trade agreement with the United States, called the Transatlantic Trade and Investment Partnership (TTIP). In the guidelines for these negotiations, the member states agreed that the EU should seek to include provisions on investment protection and investor-to-state dispute settlement (ISDS) in the proposed agreement, reasoning with existing treaties between EU member states and the US and a general policy of the EU to include such provisions in its trade agreements. Given the strong public interest in this issue, the European Commission started in March 2014 consulting the public in the EU on a possible approach to investment protection and ISDS and outlined a series of innovative elements in an explanatory notice.  

As a basic principle, the Parties’ right to regulate and to pursue legitimate public policy objectives shall be explicitly reaffirmed. When the state acts in a non-discriminatory way to protect the public interest, guarantees shall be provided so that the measures it takes cannot be considered equivalent to an expropriation. Neither a loss of profits by the investor nor compulsory licenses issued in accordance with WTO provisions guaranteeing access to medicines shall be considered an expropriation. The obligation to provide ‘fair and equitable treatment’ will be defined within precise limits by a list of acts that could constitute a breach: manifest arbitrariness, denial of justice, abusive treatment such as coercion, duress or harassment. As in other EU free trade agreements, in the TTIP the Parties would be able to adopt and enforce prudential measures – preventive measures taken by a state to ensure the stability of its financial system. Shell companies shall not be protected, only substantive business operations in the territory of one of the Parties could qualify a company as an “investor”. Abuse of the system shall be prevented by allowing for the early dismissal of unfounded claims and by preventing investors from bringing multiple claims.

The risk of ‘pantoufle’ needs also to be considered. The fact that arbitrators do not change too frequently limits the risks that an arbitrator is paid for a ruling favourable to a company by future business or employment opportunities offered to him; this risk appears as asymmetric, that arbitrators speculate on a ‘payment’ by later mandates granted by public authorities appears to the author as less likely; still, appointment as professor a.s.o. is not excluded as a benefit, making the need for cooling down periods pressing.

claims in various jurisdictions. Also, the losing party will bear the cost. Increased transparency shall be achieved by including the new UNCITRAL rules in the TTIP, with the effect that all ISDS documents will be publicly available, hearings will be open to the public and interested third parties – such as NGOs – will be able to intervene during the proceedings. Conflicts of interest or bias in arbitrators shall be prevented by a code of conduct with specific and binding obligations for arbitrators, including on conflicts of interests and ethics together with rules on how these should be enforced. Better consistency and control shall be ensured through an appellate body to review awards. Control of the agreement shall be kept by allowing the Parties to the agreement to agree on how they interpret a certain provision. This interpretation will be binding on the arbitral tribunal and direct the interpretation by arbitrators. The Parties can also intervene in ISDS proceedings to present their views on how the agreement should be applied. A further element shall be that ISDS will only apply to breaches of the investment protection provisions and not to other parts of the TTIP agreement. In particular, ISDS shall not apply to market access or regulatory provisions.

The Commission estimates that these provisions will correct the apparent weaknesses in investment agreements. The EU will have difficulties in conceding less than these provisions in treaties with other states. A tendency to abrogate these treaties could therefore be stopped.

The Business Case
HOLCIM - A Failed Investment in Guatemala

On Holcim as a company see the box above. Holcim’s stake in Cementos Progreso in Guatemala dates back to the year 2000, when the company acquired a participation of 20% in the only cement producer in the country. At the time, Cementos Progreso operated two plants relatively close to the capital of Guatemala City. Cementos Progreso was founded back in 1899 by Carlos Fedérico Novella and is still controlled by the Novella family. The latter belongs to the most influential families in Guatemala. On the company’s homepage, Cementos Progreso makes reference to a foundation, a sport stadium in Guatemala City and a museum sponsored by the company to show the owners’ close ties to the country.

The interest of having Holcim as a shareholder of Guatemala’s cement producer was mutual. At the time, Holcim was present in neighbouring Mexico (where Holcim operates now 7 plants) and in El Salvador (where it currently operates 2 plants). The possibility of entering the country’s market by an own investment hardly existed. As an article prepared by the University of Denver’s Sturm Law School states: “Although laws discussing the country’s disfavour for monopolies exist in Guatemala, the lack of enforcement and compliance with these laws has engendered a market riddled with monopolies and oligopolies.” On the side of the Novella family, the interest was in gaining access to Holcim’s technology and organisational knowledge. The plan to construct a third plant was already known when Holcim acquired its stake. The perspective of an opening up of Guatemala’s cement market through free trade agreements with the USA and Mexico may also have played a role in allying with Holcim. As Carlos Castillo, CEO of Cementos Progreso stated in the newspaper Prensa Libre, Holcim annually showed its interest to take over the company. The family regularly refused such proposals, however.

In 2005, Cementos Progreso obtained the authorisations to erect a third plant in San Juan Sacatepéquez from the Ministries of Environment, Energy and Natural Resources. A driver of the

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151 The indications in this section are based on generally accessible sources such as the company’s site on the internet.
155 The following informations are essentially taken from Barbara Müller: Guatemala, Landkonflikt - mit freundlicher Begleitung aus der Schweiz, Correos de las Américas - Nr. 160, 21. Dezember 2009, may
The project was the planned construction of a ring road providing to a series of townships better access to Guatemala City. Linked with the construction of a third cement factory was the authorisation to exploit a large surface for mining of needed minerals. This surface appears to correspond to a large share of the territory of the 12 communities within the Municipality that later fervently opposed the project. The municipality did not oppose the decision, nor did it inform the population. Other aspects of how the project was launched are also revelatory for the oligarchic structures that characterise the country. The construction of the road was launched as a public private partnership (PPP). Cementos Progreso should assume the construction of several kilometres of the road, a critical aspect, as later events showed, since it gave the company the right to expropriate. No indications are available saying that the PPP was put to tender.

San Juan Sacatepéquez, where the plant should be located, is primarily inhabited by indigenous people from the Maya Kaqchikel community and is relatively densely populated. After the Spanish invasion of 1525, the indigenous people were dispossessed of their land to such a degree that in 1752 they even had to purchase a total area of 480 caballerías (equivalent to 44.4 acres) and 38 blocks of land from the King of Spain. The municipality currently occupies 242km² and has many rivers which facilitate agricultural production. Remarkably, the producers in the region are active in the business of exporting flowers. The twelve communities within the Municipality opposing the project count some 9,000 people. According to the Guatemalan Constitution these communities can create Comunitarios de Desarrollo (COCODEs).

The extension of the planned mine (19km²) is considerable. It englobes the ‘finca’ of a former Army officer who was one of the first to organise opposition against the project. Soon afterwards, the indigenous population also manifested its opposition. Concerns were raised regarding the dust the extraction of the minerals would cause. Concerns were also present regarding any influence the mine could have on surface and ground waters. Finally, a cement plant may be used to dispose of contaminated materials. In spite of the fact that incineration in cement plants is one of the best ways to dispose of such waste, fears were expressed regarding an emission of noxious dioxins and furans in the environment.

In principle, the minority stake Holcim had in Cementos Progreso should have calmed such fears. The company has broad experiences with the treatment of critical waste from other plants in the world. It is clear, however, that throughout the world populations prefer to have such industrial sites elsewhere, preferably at the opposite end of the country. The environmental aspects of the project had been externally reviewed, however, and there are no indications that environmental concerns may be advanced to oppose the realisation of the project.

The crucial point is the ILO Convention No.169 on Indigenous & Tribal People’s Rights and whether the Guatemalan authorities had paid due attention to the rights this convention confers on indigenous populations. In reaction to the communities’ request for information after Cementos Progreso started land surveying, the municipality of San Juan promised to organise such a consultation but postponed it several times. The consultation was then organised by the communities themselves. The highest Court protected the right of the Consejos Comunitarios de Desarrollo to hold such conventions but stated also that these do not have a final say. The consultations opened the way to several attempts at a formal dialogue, one also supported by the German Ambassador and the German development organisation GIZ. The usefulness of such a dialogue may be questioned, however. It may calm opponents while promoters go on to create a ‘fait accompli’. On the opponents’ side, there is no guarantee that all interested people are free to express their opinion. Finally, the question remains open who shall qualify as being concerned by a project: What voice to give to the other communities within the Municipality and beyond?

Throughout these years, the opponents tried to get Holcim more involved in the dispute than the company considered appropriate. Cementos Progreso was e.g. declared in statements of opponents as a subsidiary of Holcim whereas the

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159 The noxiousness of Dioxin when emitted in the atmosphere became generally known by the incident at the Icmesa plant in Seveso, 20km from Milan, in 1975.


161 Contrary to what some NGO-texts suggest, the local population appears as divided. The presence of internally displaced persons looking for jobs appears to further complicate the situation.
speakers of Holcim always insisted on their position as a minority shareholder. A culminating point was a publication by Friends of the Earth on Holcim in Latin America.¹⁶² This leaflet induced Holcim to put a reply to the allegations in the publication on the company’s internet site.¹⁶³ The opponents rallied support from several MNE-critical organisations in Europe. Since representatives of the local communities feared repression, these organisations submitted on their behalf a request for a formal dialogue with Holcim. CEO Thomas Knoepfel responded to Guatemalan Peace Nobel Prize winner Rigoberta Menchú who got also involved in the case that Holcim is only a minority stakeholder, that the responsible person for Corporate Social Responsibility had visited the place and that they had elaborated with Cementos Progreso a series of actions to be taken. He promised that the CSR responsible would meet the Fundación Rigoberta Menchú on a next visit.¹⁶⁴ This reply may reflect the reality of the division of powers of the two partners in the joint venture, but the reply was of course considered by the opponents as a cheap excuse.

The high propensity in Latin America to have recourse to violence¹⁶⁵ had quickly led to a series of tragic events. In July 2008, a worker of Cementos Progreso was killed, and only one month later, a lawyer known as a defendant of the Maya people barely escaped an attempt to kill him. Typical for situations where opponents cannot dialogue, the other side is alleged to have instigated violence or to be the sole author of infractions of public order. Incidences where the responsibility falls on own people are either not mentioned or it is suggested that they might be due to “agents provocateurs”,¹⁶⁶ sent out by the side holding closer contacts to the government and its police and armed forces in order to justify repressive acts.¹⁶⁷

On 21 December 2012, Holcim communicated that the company had sold its 20% stake in Cementos Progreso to the company’s majority shareholder. The action was declared part of Holcim’s Leadership Journey, aiming at reducing the company’s indebtedness. The reduction by 10% of Holcim’s stake in a cement group in Thailand attracted more attention in the business

¹⁶² Friends of the Earth: Holcim in Latin America: Case studies, Bogota, March 2011.
¹⁶⁴ The letter can be retrieved on the following site: http://www.multiwatch.ch/de/p97000696.html
¹⁶⁵ Among 175 countries for which homicide rates are indicated in the Human Development Indicator database 2014, Guatemala ranks 7th among the worst countries, with 38.5 persons killed per 100’000 inhabitants, only topped by its immediate neighbours Honduras, El Salvador and Belize, plus Venezuela, Jamaica and, outside the Americas, Ivory Coast. Counterexamples can hardly be found in the region. Cuba with 5 killed and Costa Rica with 10 killed per 100’000 inhabitants do not perform well. Chile as the best performer in Latin America has a value corresponding to the average in the two world regions ‘Europe and Central Asia’ and ‘South Asia’. Canada, with a rate of 1.5 the best performer in the whole of the Americas, does perform only slightly better than the whole of East Asia and the Pacific with a rate of 1.8, but there are among the 175 countries 30 countries with rates of 1 person killed or below; this means that the risk of being killed in one of these 30 countries, among them China and Japan, is some 40 times lower than in Guatemala. Given the apparent correlation with prosperity, personal security appears to the author as a major development problem. It would be myopic to pursue for this reason a policy of repression, however. The USA, ranking first in the world with respect to the share of the population imprisoned — at a rate seven times as high as in the EU-15, making fighting criminality a disproportionately important business on the Western side of the Atlantic - has a homicide rate of 4.7 persons over the 2008-2011 period. Sadly enough, the needed change in deeper underlying societal factors takes time. An improvement, both in prosperity and personal safety, is only to be expected over decades.
¹⁶⁶ More likely appear continuous harassments to provoke a disproportionate, non-justifiable reaction by the other side.
¹⁶⁷ The report on the events of 22 September 2014 by the Centro de Medios Independientes de Guatemala (CMI Guatemala) of January 2015 testifies to the difficulties of making out who committed acts of violence, what the exact sequence of events was and whether there was instigation by exponents of either the promoters or the opponents of the project. It appears that acts of homicide are committed regularly by the gangs and for sometimes banal reasons, so that it may be difficult in this climate of general intimidation to link single criminal acts to single undertakings. See: https://cmiguate.org/los-primeros-los-ultimos-y-los-proximos-muertos-de-san-juan-sacatepequez/
press than the retreat of Holcim from Guatemala.\textsuperscript{168}

The retreat came not too late, given the reputational risks the minority stake in Cementos Progreso constituted for Holcim. On 22 September 2014, events escalated further. A landowner and his family were shot dead in a crossfire of armed inhabitants of the region. Apparently, he was targeted because he had sold land to Cementos Progreso for the connection road to the cement plant. Allegedly, the night before, an opponent had been shot by masqueraded men close to the company, but both sides are pretending that they have no link with any armed gangs.\textsuperscript{169} Notwithstanding these tragic events, the plant will become operative in 2017.

This investment of a company involved in resource extraction is revelatory of the fact that in such ventures, having a sound business case is not sufficient to avoid serious allegations. Noteworthy, in the present case, indications are missing regarding any attempt of the opponents to obtain unwarranted concessions by the promoters by letting the conflict escalate. The deep social cleavages in the Guatemalan population apparently blocked the way to compromise. Political power vested with a few families makes it in fact difficult to argue that the common interest can override the lack of interest of a local community of having a mine erected on its territory.

The problem is that countries lacking investor quality due to the handling of political power see their economic development hampered. The possibility of cement importation has now the potential to reduce rental incomes. Such reduction may also reduce the readiness to use violence. Furthermore, the chance that a competitor might use a conflict to his advantage can discipline a leading company in its behaviour. Such effects are more likely to occur within transforming industries, however. In mining, rental incomes are inherent to any project\textsuperscript{170} and in the presence of such rents dispute is pre-programmed.

In the present case, an absolute guarantee of individual ownership rights might have blocked the project, one single owner not willing to sell at a price that is not blackmail being sufficient. This is socially not optimal, either. The problem of conveying expropriation rights is, however, closely linked to the impossibility of finding decision rules acceptable to everybody when applied.\textsuperscript{171} Faced with limits to find solutions that leave no losers, decade long politics have to build up a general trust in society that sufficient voice is given to any legitimate interest. Obviously, this precondition is not met in numerous countries. Then, a high propensity to have recourse to violence, a problem particularly present in Central America, makes it difficult to avoid tragic outcomes.

\textsuperscript{168} Global Cement: Holcim’s Journey Continues, 2 January 2013 \url{http://www.globalcement.com/news/item/1343-holcim%2E%20%E2%80%99s-journey-continues}

\textsuperscript{169} Centro de Medios Independientes de Guatemala (CMI Guatemala): Report of January 2015 on the events of 22 September 2014 (see footnote 54 above). The company’s point of view can be found on Cementos Progreso’s homepage under the title: The truth about the tragic events in the community Los Pajoques, San Juan Sacatepéquez, Guatemala, September 22nd, 2014

\textsuperscript{170} Strictly speaking, this is not the case for the marginal project (i.e. the project that is just expected to break even) but in the presence of risk aversion such projects with no margin will hardly ever be realised. If the risk margin is later not needed, the problem of rental incomes reappears.

\textsuperscript{171} It appears as indispensable to project at one stage in the decision making process over an expropriation the valuations expressed by the involved persons on an ordinal scale; ranking them is insufficient (see \url{https://en.wikipedia.org/wiki/Arrow%27s_impossibility_theorem}). An ordinal scale says that the valuation by affected person A of chosen alternative X is a certain amount less worth than the benefit accruing out of the realisation of this alternative to affected person(s) B and that alternatives Y and Z show a smaller excess of benefits over losses. Of course, to take away 1$ from a rich person should by this projection be valued less than to take away 1$ from a poor person. Not only the exact balancing factor between income classes will remain controversial within society, however. Wealth is not the only factor to consider. The application of the decision rule should also not leave always the same community on the loser side. This appears as indispensable even when the calculated difference in valuation is paid as an indemnity to affected person A because the valuation applied is not his resp. the one of his community. This individual valuation will reflect inter alia also the fact that opportunities for new ventures shall not be the privilege of an oligarchy, an aspect cost-benefit analyses will normally not consider.
Part IV
The Construction of the Churchyard Quarters in Bern

Urbanisation in the 19th century as background

Bern is built on a river loop, the northern, eastern and southern riversides along this loop climbing relatively steeply and by about 40m above the level of the river, the Aare, before giving way to flat terrain. Accordingly, the onset of population growth, the demand for commercial space and the general urbanization in the first half of the 19th century led to a westward expansion. The fortifications were razed and a disorderly settlement along the outward roads sat in. In spite of being much closer to the centre of the town, and made up of large flat fields, the Hospital Yards in the north (Spitalacker) and the Churchyards in the south (Kirchenfeld) remained virtually untouched, even after the construction of bridges at river level. In order to contribute to the revitalisation of the Old Town, in 1844, the Nydegg-Bridge was opened, extending the east-west axis of the town beyond the river. In 1856, the community of the families having Bern as its town of origin took over the Churchyards in the south, which had passed to municipal ownership in the aftermath of Reformation. Within this civic community (existing side by side with the municipality of Bern) soon voices were heard who desired an exploitation of these idle assets. Main obstacle to the realisation of profitable projects were the high costs for constructing a bridge over-arching the river at a height of some 40m. Due to the financial losses the corporation had suffered when funding the Nydegg-Bridge, caution had spread in the local community. But the idea remained.

Architectural inspirations from all over the world

A first concept for the urbanisation of the Churchyard Quarters was submitted in 1859 by Friedrich Studer and his partner Edouard Horace Davinet, based on a checkerboard pattern aligned in east-west direction, similar to the towns erected in the US founding period, the quarters being surrounded by English gardens, including also the Dählhölzli Forest. But continental influences were also present. In 1865, a project baptised "Rond-Point" thus showing the source of inspiration proposed a square in the area of present-day intersection Thunstrasse/Dufourstrasse with radiating roads. The author, the engineer-topographer Philip Gosset had been born 1838 in Bern.

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172 The text is mainly an extraction and translation of an article prepared by the 'Stiftung Kulturgüterschutz'. http://www.sgkgs.ch/fr/Biens-culturels-Monuments-historiques/Bern/Bern-Villenquartier-Kirchenfeld
as an Englishman, but received his engineering degree in Paris; he later built up a reputation as a glaciologist. In 1870, as a next step, a Churchyard Committee got constituted by businessmen, bankers and wealthy citizens, but also some engineers and architects plus a representative of the municipality. This committee submitted its proposal in 1875, a grid plan with irregular quarters, broad avenues and a polygonal square, the whole aligned to a bridgehead located at the extension of main axes of the ancient town. However, all these projects failed to address the concerns of the conservative civic community. The committee was successful only when a proposal could be submitted to the authorities not requiring “any substantial sacrifices” by the city. Philip Vanderbyl, a financier from London, declared “on behalf of a group of English capitalists” who joined forces for the “Berne-Land Company” to be ready to build the bridge for free, as long as the Churchyard fields (approx. 80 ha) were sold to the Company at a price of CHF 425,000. The Company also committed to cede land for free for public buildings and churches, and to create all roads according to an agreed plan.

Helvetia Square, Jubilee Place and Thun-Square should become the points where the new roads would meet. The Thun-Square was located at the intersection point of the two visual axes: House of Parliament - Helvetia Square – Thun Avenue and Minster Platform - Mermaid Street – Bernese Alps. Similar considerations determined the location of the Helvetia Square and the Jubilee Place. The project found the approval of all authorities and in 1881 began the construction of the bridge. It was opened two years later with cannon fire, a folk festival and the first Bernese bike race.

So clearly the grid plan of 1881 was fixed in the contract, it said nothing on the subdivisions of the single yards and the architecture of the new buildings. Only the construction of factories was prohibited close to the riverside. And the propaganda brochure of the committee declared clearly that no “proletarian quarters” would be constructed, the high prices of the terrain making this for sure. The residential building type of the 19th century, the villa, should dominate. The most significant change to the plan of 1881 affected the Helvetia Square where - following the spirit of a subsequent period - the Historic Museum was placed in the extension of the southern bridgehead, a building with uncut stone walls and towers, suggesting a medieval castle.

To the surprise and chagrin of the Company, the sale of building lots was more than sluggish. However, despite faltering sales, the target was in the end substantially achieved: the Churchyard quarters became a district of villas and residential buildings, supplemented by “upscale” services such as several museums, the National Library and the Federal Archives. It is more than symptomatic that the only major industrial plant, including a high chimney, erected in the Churchyards was a money factory, namely the Federal Mint.

In order to accelerate the sale of building lots finally a construction company was founded which created turnkey villas and sought buyers. The “Berne-Land Company” also launched an architectural competition for villas, to gain ideas and to attract the attention of the “real estate community”. Among the submissions, in an age of stylistic pluralism, projects representing different tendencies were chosen: one type was representative of the generally popular English cottage style, another design was in a rural style, finally two urban building types found approval. Architectural quotes were taken from the whole world, “style” in these times meaning attitude, general impression. The bumpy rhyme which survived well into the 20th century confirms this “Who thinks highly of himself, lives on the church yards.”

The Company later admitted a number of tract houses, which, however, had to dispose of symmetrical corner buildings and a prominent central building, suggesting a palace-like construction.

Comment

Three aspects deserve attention:
- to launch a large scale project allowed for systematic planning, the westward expansion of Bern never having achieved comparable architectural quality,
- the project is an early example of a successful public-private partnership with injection of foreign capital into land ownership, and
- with growing prosperity, ownership was gradually dispersed over a broader population group.

The experience with the venture of the Berne-Land-Company questions the economic soundness of the provisions know all around the world which make access to land for foreigners much more difficult than access to other assets with which the owner can effectively run away. To date, the Churchyards remain the city’s embassy district. When it is argued here that foreigners cannot escape the reach of the jurisdiction in which their land is located, this is therefore not entirely true: Embassies are extraterritorial!

173 „Wer etwas auf sich hält, wohnt auf dem Kirchenfäd“.