More and Better Infrastructure in Guatemala

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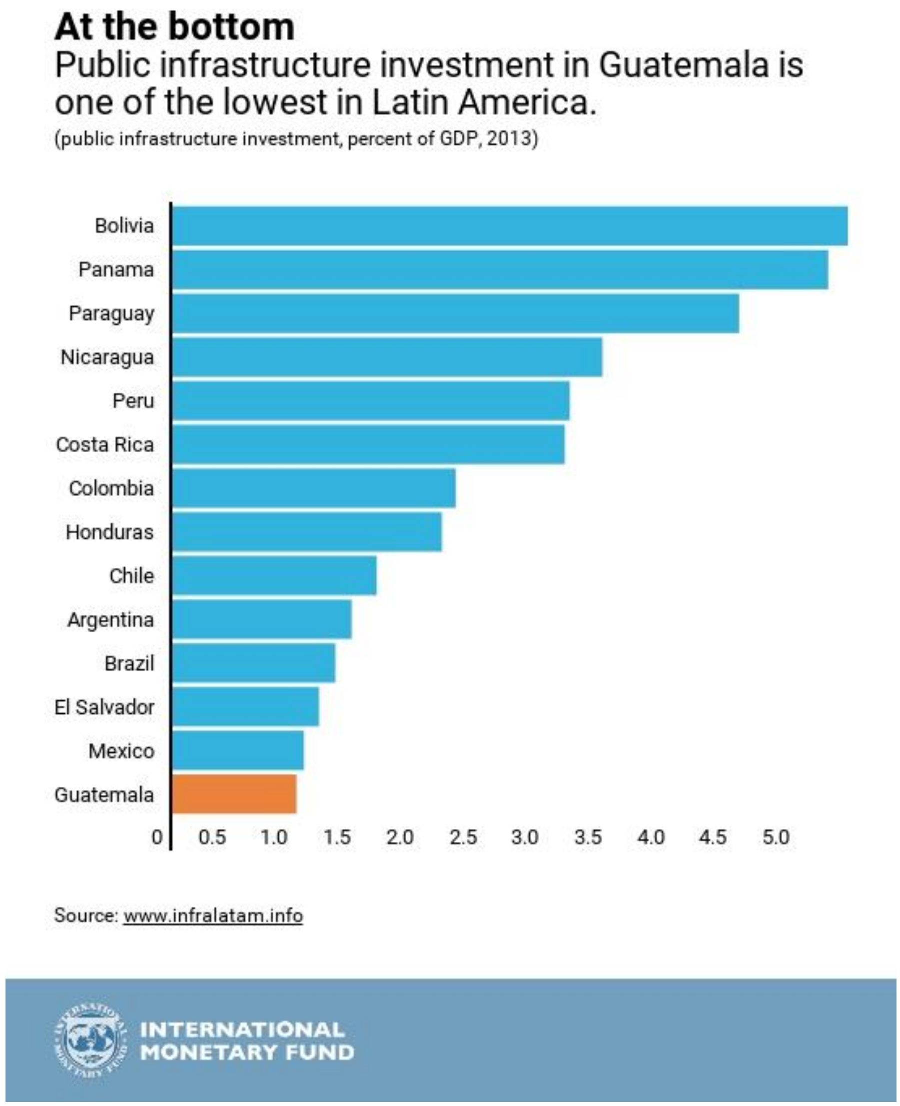
At less than 1 percent of GDP, public infrastructure investment in Guatemala is among the lowest in Latin America and emerging markets. The resulting infrastructure gap constrains Guatemala's future growth and living standards. This has a particularly large effect on the poorest households.

The benefits of higher, well-targeted public investment in infrastructure would greatly exceed the fiscal costs and would promote Guatemala's economic and social development. The time is ripe for a sizable increase in infrastructure spending in Guatemala.



Large gap

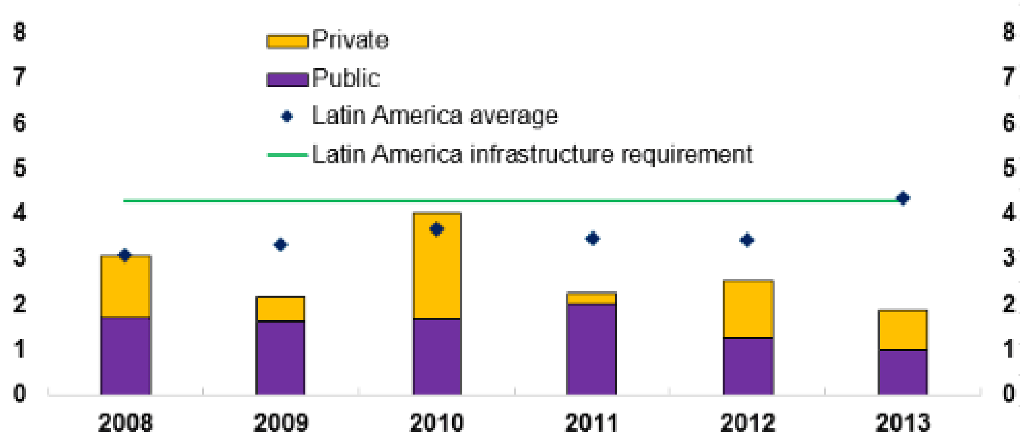
Although Guatemala has made significant progress in achieving macroeconomic stability, its average output growth of 3¾ percent over the past decade has been insufficient to lift Guatemala's people out of pervasive poverty. Guatemala faces high levels of poverty and malnutrition, income inequality, and one of the worst violent crime rates in the world. While pro-poor spending and social policy reforms can help tackle some of these social needs, an acceleration in economic growth will be essential to achieve durable gains in reducing poverty, malnutrition, and crime. At present, Guatemala's growth potential is constrained by inadequate infrastructure.

In recent history, infrastructure investment in Guatemala has fallen short of the estimated needs by a large margin. Of even greater concern is that, as other Latin American countries are closing their infrastructure requirement gaps, Guatemala's is increasing.

Large gap

Guatemala's infrastructure investment gap is increasing.

(infrastructure investment, percent of GDP)



Sources: www.infralatam.info; Guasch, Jose L., 2016, Private and Public Investment in Infrastructure-PPP/Concessions: International Experiences and Identification of New Practices for Success, IPEA Working Paper.

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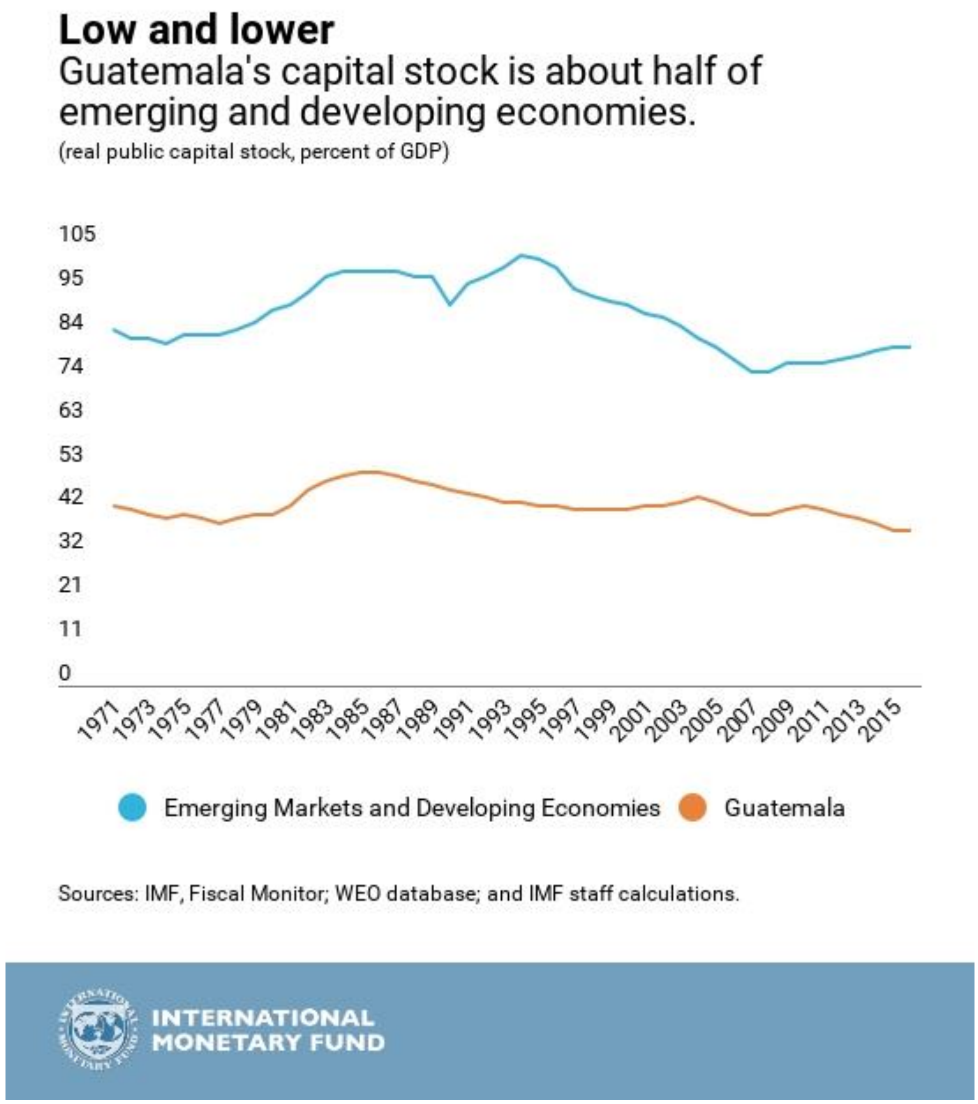
As a result, the public capital stock in Guatemala is about one-half of other emerging market and developing economies.



More investment in infrastructure

Inadequate infrastructure has been identified as one of the most important obstacles for doing business in Guatemala (see Global Competitiveness Report) and has held back foreign investment. Poor infrastructure has also been a major impediment to regional integration and trade (as private companies have struggled to get their merchandise to borders, ports, and airports). Moreover, infrastructure deficiencies are keeping the cost of basic goods high, suppressing competition. As one example, poor infrastructure has contributed to sustained high food price inflation over the last few years, especially in rural areas. This has particularly hurt the poor for whom these basic goods represent a large share of consumption. Finally, the quality of infrastructure varies greatly across Guatemala, which exacerbates regional income inequality, particularly between urban and rural areas.

The bottom line is this: more investment in infrastructure would have a high return both in terms of growth but also in reducing Guatemala's poverty and income inequality. Better surface transport networks would facilitate regional trade and within-country transportation, increasing the availability of goods and lowering prices. Better access to infrastructure services in rural areas, where most of the poor households live, would have a substantial positive impact on living standards. And lower logistics costs, by improving competitiveness, would create employment that would disproportionately benefit poorer households. Furthermore, if that public infrastructure investment were financed through a temporary increase in the fiscal deficit, it would boost near-term demand and support job creation.

Expected boost

Our simulations indicate that a sustained 1 percent of GDP increase in public investment would, over the next 5 years:

- raise output by 1.2 percent (in line with IMF findings that a 1 percent of GDP increase in infrastructure spending would, on average, raise GDP by around 1.5 percent in both advanced and emerging economies); and
- lower extreme poverty from 23 to 18 percent of the population.

Choose carefully, execute efficiently

Of course, these results assume that the public investment is well-targeted to the areas of greatest need. Less efficient project selection would significantly dilute these potential gains. IMF work shows that the most efficient public investments are able to generate twice the growth impact compared to the least efficient ones.

Therefore, to reap the full benefits of public investment, Guatemala needs to ensure transparency and well-governed institutions at each of the planning, allocation, and implementation stages of the investment cycle. That requires coordination across sectors and levels of government, objective procedures for appraising and selecting projects, transparency in monitoring projects, and effective management with high governance standards.

In conclusion, expanding infrastructure spending today is a very feasible proposition for Guatemala given its history of fiscal responsibility, low public debt, relatively cheap financing costs, and expected high returns from well-conceived infrastructure projects. The government's announced plan to reactivate infrastructure investment is promising. Now is the right time to invest in Guatemala's future.

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