# Train Wreck in Guatemala

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Henry Posner III is an American entrepreneur who has revitalized rail systems in Peru, Argentina, Mozambique and Malawi. He also has been working since 1996 to revive rail service in Guatemala. But now Mr. Posner's Pittsburgh-based company, Railroad Development Corp., is suspending operations in the Central American country, charging that the government has violated RDC's 50-year concession contract and refused to enforce the company's property rights.

"Because of the government's action and the lack of the rule of law in Guatemala, we have no other alternative," Mr. Posner wrote in a letter to customers, investors and employees on July 6.

For Guatemala, the matter is more serious than a simple dispute about a state concession. Mr. Posner, who is chairman of RDC, is taking his beef to international arbitration under the Central America Free Trade Agreement (Cafta) and asking for $65 million in lost revenues and investments. In its complaint to the Cafta panel, the company also charges that there is method to the government's maddening mistreatment of the company: It wants to "redistribute to certain Guatemalan private-sector companies the benefits of the right-of-way, without compensation."

If the American businessman prevails, the case will reinforce the country's traditional image as a banana republic uninterested in equality under the law and ready to trample property rights whenever it is politically expedient. What else are investors to conclude if it turns out that President Oscar Berger's "right-of-center" government, which pays lip service to property rights, has unilaterally abrogated a lawful contract? This would be a blow to all Guatemalans, who need investment in their country if they are to benefit from and compete within Cafta.

Transportation infrastructure is crucial to economic development in any country and Guatemala is no exception. In the early part of the 20th century the country had a national railway that was largely the product of investment by an affiliate of United Fruit. It was nationalized in the 1960s and over three decades run into the ground. By 1996, it was completely defunct.

That left the country's distribution system entirely reliant on a costly, polluting highway system subject to congestion, accidents and rampant hijacking. In 1997 Guatemala held a World Bank-style, sealed-bid tender process for the concession that was to restart the dead railroad. RDC won. In December 1999, Ferrovías Guatemala's first train chugged out of the Atlantic coastal city of Puerto Barrios on its maiden journey to the capital. Mr. Posner says that the concession included the right-of- way on the old rail line that runs out to the Pacific at Puerto Quetzal, north to Mexico and south to El Salvador as well, and that RDC promised "best efforts" to get the Pacific side going.

In 2005 the railroad shipped some 150,000 tons of traffic -- mostly steel, as well as containers -- on the Atlantic route but it was having a lot of trouble with the government. Mr. Posner says the terms of the concession included a government pledge to remove squatters from the railroad right-of-way and to redirect half of the lease payments from railroad-owned assets toward track maintenance and improvements. The squatters were never resettled elsewhere -- photographs support this claim -- and, he says, the lease revenue "disappeared and we had to replace it."

In 2005, RDC tried to get Guatemala to go to binding arbitration as provided for under the concession. But the government refused, arguing that it was not bound to do so. The government also says that the company has not kept up its side of the agreement by investing in the country. While Mr. Posner says his company has invested $15 million in the railroad, President Berger has said that the concessionaires "have not invested one cent." In August 2006, the government declared the concession "harmful" to the interests of Guatemala and moved to confiscate the railroad's rolling stock and equipment. The company says this inflicted further damage on it as investor confidence plummeted and its ability to access credit markets was strained.

Still, Mr. Posner says the railroad could have continued to operate were it not for Guatemala's indifference toward another of its property rights. The company's business plan had included charging for use of the right-of-way for electricity distribution, pipelines, fiber optics and the like. This was stipulated in the concession and would have subsidized rail operations. But while some local companies paid for that use, others began free riding along the right-of-way. When RDC appealed through the Guatemalan legal system for protection in the matter, the courts sided with the commercial squatters. This signaled the market that what is essentially theft would be tolerated, and RDC lost an important source of revenue.

The World Bank hasn't been much help either. It declared Ferrovías Guatemala's property a "category A environmental problem" because of the squatters and refused to lend to it. Mr. Posner says the bank's position was that he had to prove to the satisfaction of the squatters that RDC has done no harm. "That's like handing someone a loaded gun while you open your wallet and negotiating from there," Mr. Posner says. No wonder no one takes the Bank seriously. It lends to Mexican billionaire Carlos Slim but when it comes to defending property rights it runs for cover.

Most troubling in all of this is the charge in RDC's Cafta complaint that in driving the company out of the country, the government seeks to satisfy special interests. There is talk that a cross-country rail system designed to compete with the Panama Canal would be a big money maker as Asia booms. And while Mr. Posner dismisses that idea, he notes that the rail right-of-way is immensely valuable for more than simply hauling freight. Whatever the reason for breaking the concession, it's hard to see how it won't harm

Guatemala's image with foreign investors at a time when the country ought to be courting them.