

CGD Brief

Poverty and Inequality in Latin America: How the U.S. Can Really Help

By Nancy Birdsall and Peter Hakim¹

The Bush administration woke up recently to the fundamental challenge Latin America faces: undoing the injustices reflected in that region's longstanding poverty and social inequalities. During a week-long trip to the region in March, President Bush said that the United States was newly determined to help its neighbors tackle their long-neglected social agendas. Three months later, he hosted a White House conference on "Advancing Social Justice in the Americas," again highlighting a new U.S. policy commitment to help Latin American countries alleviate pervasive poverty, combat widespread racial and ethnic discrimination, and reduce the income and wealth gaps that make Latin America the most unequal region in the world.

A U.S. focus on social issues in Latin America would be a refreshing change. For the last two decades, Washington's limited attention to Latin America has concentrated on free trade, narcotics trafficking, and security threats. Not since President Kennedy launched his Alliance for Progress in 1961 has social development been the centerpiece of U.S. policy in Latin America.

While the bulk of reforms to address poverty and inequality must come from the governments, corporations and civil societies of Latin America itself,² there is a lot the United States can do. The most important question is not whether Washington is willing to make the resources available. Though more resources would help, the size of the U.S. aid budget pales in comparison to private capital inflows and remittances (for some countries), and President Chavez's aid and cheap oil amount to more than four times U.S. spending on aid for the region in 2006 of \$1.4 billion. The fundamental question is whether this and the next administration will stay focused long enough to overhaul tired and sometimes foolish practices in aid, trade and other areas in favor of a strategic and practical approach.

This brief describes the political risks poverty and inequality pose for the region and the hemisphere, including the United States, and then lays out a practical agenda for how the U.S. can help. Chief among the recommendations:

- Buttress free trade agreements with aid programs that compensate the losers (such as farmers competing with subsidized U.S. agriculture) in the short run and help to increase their ability to compete or adjust in the long run
- Include redistribution of land and investments in alternative employment programs in the so-called "war against drugs"
- Push U.S. banks to lead the way in making banking in Latin America accessible to the poor
- In Brazil, Mexico and other middle-income countries, fund small aid programs aimed at engaging those countries' poorest—often minority and indigenous groups
- Use aid for education to support reform of hidebound school systems
- Help Latin America confront its surge of crime and violence by stemming illegal small arms sales in the region and supporting police reform

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² See Nancy Birdsall, Augusto de la Torres and Rachel Menezes, *Fair Growth: Economic Policies for Latin America's Poor and Middle-Income Majority* (Washington, D.C.: Center for Global Development and Inter-American Dialogue, Fall 2007).

Poverty and Inequality in Latin America— and its Consequences

With his vitriolic campaign to oppose the United States and install “21st century socialism” in Latin America, Venezuela’s firebrand President Hugo Chavez has demonstrated how deeply the call for social justice resonates across the region. Nearly 20 years of U.S.-backed economic and trade reforms may have enjoyed some successes: reducing inflation (the single greatest tax on the poor), dismantling patronage-ridden state enterprises, and providing the macroeconomic stability that has enabled the region to benefit from the booming global markets in food and mineral exports—soybeans, cotton, coffee, nickel, copper and a range of other commodities. But even with the resulting surge of growth, some 40 percent of Latin America’s citizens still live in poverty, a figure that has changed little in the past quarter century. Joblessness is higher in 2007 than it was in 1990, and deep inequality remains the region’s hallmark. In most countries, less than 10 percent of the population controls more than 50 percent of the wealth—and an even more disproportionate share of real political influence. At his first inauguration in 1995, sociologist turned president Fernando Henrique Cardoso said “Brazil is not an undeveloped country; rather it is an unjust one.”

The consequences of such economic and social imbalances are high: many Latin Americans feel alienated from their own leaders and uneasy about “markets” and “globalization.” Politics have become polarized in country after country, making it harder to govern and increasing the prospects of internal conflict. The U.S. is widely seen as defending its own narrow commercial interests in the region, as the champion of market reforms that have failed to help the poor—and as wholly indifferent to Latin America’s social and political tensions. This has contributed to deep and widespread anti-U.S. sentiment. In these circumstances it is no surprise that Latin Americans are electing leaders who promise an alternative to U.S.-backed policies. Last year, supporters of Hugo Chavez won presidential elections in Bolivia, Ecuador and Nicaragua. A small shift in voter sentiment might well have given Chavez new allies in the larger and more influential countries of Mexico and Peru. In all these countries, demagogic politics and populist leaders threaten to undo the fiscal and other reforms implemented in the last two decades that have been, while not always perfect, an important step towards making life better for the region’s majority.

Meanwhile, the United States has not begun to match the thought, energy or resources Hugo Chavez is investing in the social agenda. The Bush administration’s initial proposals—

visits by a hospital ship to various Latin American ports and increased scholarships for study in the United States—are a feeble response. Expanded funding for home mortgage loans and a subsequent announcement from Treasury Secretary Paulson of a new U.S. fund to step up lending to small- and medium-sized enterprises in Latin America are in the right spirit—but are also small and piecemeal. Overall the recent announcements don’t add up to anything resembling a forceful or well-considered strategy to deal with the hemisphere’s vexing social inequalities.

Some current U.S. programs are relevant to an attack on Latin America’s social problems; they just need to have a more visible and robust social dimension.

A New U.S. Agenda in Latin America

Trade Plus Aid: Buttressing Free Trade Agreements With Help for the Losers

The United States should worry about who benefits (and who does not) from the trade agreements it negotiates. Free trade agreements are spurring exports and investment and encouraging better economic management in the region. The resulting jobs and growth can potentially contribute to reducing poverty—but only if complementary policies ensure that the benefits are extended to excluded groups. Otherwise free trade can end up mostly serving the economically better-off, while others fall behind and income disparities widen.

The United States has reached bilateral trade deals with 11 Latin American countries³ (three still require U.S. congressional approval). But according to even their strongest supporters, the terms of the agreements have been inflexible and tight-fisted. The United States, for instance, over the objections of every government in the region, continues to restrict exports of agricultural products, especially sugar, and to limit apparel exports through burdensome rules of origin.⁴ At the same time, the United States resists any reduction in its support for hugely subsidized grain products, which are displacing the corn and rice sold by Latin America’s unsubsidized and un-mechanized peasant producers.

A better U.S. trade policy in Latin America should aim to increase the number of winners from the bilateral trade agreements it negotiates, and ensure that potential losers are compensated in one way or another. To increase the number of winners agreements should include U.S. financing for the training of workers and technical assistance to small firms—a form of trade adjustment assistance to trading partners. Reducing the number of losers requires that the U.S. government stand down big agribusiness, pharmaceutical and other

³ Chronologically (by completion of negotiations) they are Mexico, Chile, Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, Peru, Colombia and Panama (although the last three still require congressional ratification).

⁴ See Kimberly Elliott, *Pitfalls in Asymmetric Negotiations*, CGD “Have a View” (Washington, D.C.: Center for Global Development, 2006).

interest groups that have traditionally hijacked trade negotiations (often disregarding the real long-term interests of even U.S. producers and consumers). Though politically contentious, it can be done, as suggested by the recent agreement between the congressional leadership and the administration to loosen the requirements for stronger intellectual property protections if they impede policies to promote public health.

In addition and in the meantime, the United States can more explicitly ensure its foreign aid programs reach small farmers in the region (who, without resources and technical inputs, have been losing out from trade openings) by using aid to compensate them for the competitive advantage American farmers get from subsidies, tariffs and other barriers. Aid programs should also support trading partners' efforts to increase agricultural productivity. And why not extend trade-related programs to countries that have not yet signed bilateral trade agreements with the United States, as long as they are showing a commitment in their own expenditures to education, health and other programs that ensure the benefits of more open trade markets will likely be captured by the majority of citizens?

The European Union (EU) has some experience with financial transfers to its poorest members, which were designed to reduce economic differentials among member countries. In the late 1990s, the EU's net fiscal transfers to Spain alone were more than \$4 billion a year, while transfers to Poland in the next five years will amount to upwards of \$10 billion a year. U.S. funding specifically linked to ensuring that the benefits of trade are widely shared could be much smaller (\$500 million a year for the entire region would be a good start), and would signal U.S. interest, not in free trade *per se*, but in greater and more inclusive growth in the region. In short, to advance Latin America's social agenda, Washington should replace its "trade, not aid" slogan with "trade plus aid."

From a War Against Drugs to a War Against Poverty: Land and Jobs in Coca-Growing Regions

More than one-half of all U.S. "aid" to Latin America (about \$750 million of \$1.4 billion in 2006) supports Washington's anti-drug campaign in the Andean region, predominantly in Colombia. The eradication of coca plants has long been the mainstay of this effort, but eradication, by itself, cannot produce lasting results, since no matter how much of the coca crop is eliminated, small coca-growing farmers will return to coca cultivation when they cannot find other sources of employment. The failures of U.S. policy are most obvious in Bolivia, where the singular focus on coca eradication contrib-

uted to loss of employment and livelihoods and to growing resentment in rural areas, helping to elect President Evo Morales—so far an ally of Chavez in spirit and rhetoric if not fully in practice.

The United States should shift funds away from the singular (and unrealistic) goal of coca eradication toward development and job creation in coca growing regions. And there are viable alternatives. The rapid growth of flower exports from Colombia and Ecuador, and asparagus production in Peru, illustrate the potential benefits of a focus on rural development. In Colombia, the United States has finally begun shifting a share of its anti-drug support toward rural development. But much more could be done there and in Bolivia—including comprehensive programs of land distribution and rural enterprise development targeted to indigenous and other landless peoples.

Bank the Unbanked: Making the Poor Bank Customers

Remittances—sent mostly from low-income migrants in the United States to their relatives back home—are now Latin America's largest source of external capital. The \$60 billion-plus of annual remittances are 40 times the U.S. aid program in the region, and are making a huge dent in rural and urban poverty. The United States government ought to make it official policy to enhance the social impact of remittances. One step would be for U.S. Treasury officials to use their bully pulpit—pressing the financial community to encourage U.S.-based senders and Latin-based receivers to open banks accounts and facilitate the process. The immediate payoff is lowered costs for sending remittances, putting more money in the hands of recipients. Over time, a bank account gives its owner a range of new financial opportunities (direct deposit, free check cashing, credit-worthiness, etc.). Few initiatives would do more to diminish poverty in Latin America than a systematic effort to expand the numbers of low-income families who use bank accounts. Washington should take steps both to make it easier for all U.S. residents to open accounts, and to encourage U.S. banks to work harder to recruit migrant customers.

Private U.S. programs support micro-finance throughout the region. The U.S. government could remind Latin American governments of the benefits of pressing their own banks to end the long-standing presumption that banking is only for the well-heeled. After all, microfinance institutions in many nations are making money as well as helping the poor and near-poor to capture the benefits of becoming bank customers.

In Middle-Income Countries, Help Engage Poor Minorities

Most of Latin America's poor live in middle-income countries which no longer receive large infusions of foreign aid from any major donors. For example, the Millennium Challenge Account, an innovative U.S. foreign assistance program established by the Bush administration in 2004, will serve no more than five or six of Latin America's smallest and poorest countries—which together account for less than 5 percent of the region's poverty-stricken families. In other countries, U.S. aid need not be massive. It just needs to be smart. In Southern Mexico and Northeast Brazil, the United States should concentrate on developing and supporting local innovations designed to reach and engage the poor, supporting and developing ways to reach poor and vulnerable populations, including Afro-descendants and indigenous groups.⁵

Some of this is already being done. For example, the Inter-American Foundation, a small and little-known U.S. government program, provides small grants directly to the poor in nearly every Latin American country. Such programs generate the learning about what works that local governments can then imitate and extend. Given its success over many years, the United States should scale up the Foundation's funding and activities. The Bush administration should also welcome Senator Robert Menendez's (D-NJ) imaginative proposal, soon to be introduced as legislation, to establish a Latin American-wide social development fund that would pool resources from the countries of the region with those of the United States and Canada and the multilateral development agencies.

Support Reform and Innovation in Hidebound School Systems

The dismal quality of education remains the Achilles' heel of economic and social development virtually everywhere in Latin America, despite significantly increased spending on schooling in the last two decades. In country after country, governments are failing to overcome hidebound regulations, rigid educational bureaucracies, self-serving unions, and regressive expenditure patterns. U.S. funding for education should go to the champions of serious school reform in the region, and should promote innovation and flexibility to generate the demonstration effect that would make an important difference.

Help Latin America Deal with its Wave of Crime and Violence

Crime is as devastating to the poor in Latin America as unemployment and discrimination. Latin America leads the world in kidnappings. Its homicide rate is twice the global average. Youth gangs have thrown several Central American countries into turmoil. Mexico is using its army to battle narcotics dealers and corrupt police. Brazil's two largest cities, Sao Paulo and Rio de Janeiro, have been terrorized by drug gangs. Everywhere, it is the poor that bear the brunt of this pervasive and escalating criminal violence, which is aggravated in many places by the corruption, disarray and inadequate financing of police forces and judicial systems.

Washington can best help Latin American countries stem the tide of crime by pushing the World Bank and the Inter-American Development Bank to work with countries on police reform. Signing on to the U.N. protocol on small arms trafficking would also help by at least signaling serious concern. Finally, the United States should end its practice of deporting convicted felons to their countries of origin, regardless of how long they have resided in the United States. These deportees today lead the vicious youth gangs that have become so destructive.

Conclusion: Advancing Latin America's Social Agenda Serves U.S. Interests

Right now, Washington seems to be losing Latin America. A coherent set of robust initiatives to help Latin America confront its social needs and economic divisions could start a healthy process of rebuilding the United States' lost trust and influence—which is in the interest of the U.S. as well as the region's poor majority. Latin America is much less reliant on the United States than it used to be and may need its good neighbors to the south more than vice versa in the new geo-strategic environment of this century. For more on how and why that is the case, and on how the many aspects of U.S. official behavior—from the war in Iraq, to immigration, the drug war, and sometimes overbearing diplomatic style—affect America's image in the region, see *Losing Latin America*.

Of course even an ideal set of U.S. policies and programs—in aid, trade, immigration, and crime and drug control—could not possibly, alone, do much to transform the lives of Latin America's poor.⁶ In the end it is not Washington but the region's own governments, corporations, and civil societies that will matter most. Fortunately, however, Latin America is more democratic and its governments more competent and more responsible than two decades ago. Today more than ever the most important outcome of a robust U.S. strategy to support inclusive growth may not be what it accomplishes, but what it encourages the countries themselves to do.

⁵ A good example of the importance of engaging vulnerable populations is girls education. A 2007 CGD book found that nearly three-quarters of the 60 million girls not in school in developing countries belong to ethnic, religious, linguistic, racial and other minorities. For more see Maureen Lewis and Marlane Lockheed, *Inexcusable Absence: Why 60 million girls still aren't in school and what to do about it* (Washington D.C.: Center for Global Development, 2007).

⁶ Nancy Birdsall and Rachel Menezes, *Toward a New Social Contract in Latin America*, CGD Brief (Washington, D.C.: Center for Global Development, December 2004).

Losing Latin America

By Peter Hakim

U.S. influence and credibility has badly waned in Latin America. Washington's bad policy choices are mostly to blame.

To be sure, as Latin American countries reformed and opened their economies and strengthened their democracies, they inevitably became more and more integrated into world financial and political networks, less reliant on the United States and less willing to routinely accept U.S. leadership. What was not inevitable was the growing distrust of Washington in the region and the rapid upsurge of anti-American sentiment—consequences mostly of the Iraq invasion and the subsequent conduct of the war. The combination of brutality and failure has been disastrous for Washington's image in a region long wary of U.S. power.

But U.S. policies in the hemisphere also bear blame. With the United States so totally absorbed in the Middle East, the Bush administration has been unresponsive to Latin America. And when it has tried to engage, it has often been either ineffectual or overbearing and uncompromising.

Mexicans and Central Americans, for example, were dismayed by President Bush's failure to deliver on his promise to make U.S. immigration practices less punitive and more welcoming. Trade policy has been an area of some success for the Bush administration, but the rigidity of U.S. negotiating positions have rankled even the strongest proponents of free trade. The United States remains out of step with the great majority of Latin American countries on several other key issues, most importantly, on Cuba and anti-drug policy.

In addition, Latin Americans often bristle at the style of U.S. diplomacy and politics—and the attitudes that underlie them. With some justification, they feel that Washington still views the region as its backyard and expects governments there to consistently follow the U.S. lead.

Latin America will not be a foreign policy priority for the next U.S. president. It will not be a central front in the war on terrorism. Nor is Latin America expected to offer the oversized economic opportunities of rapidly growing China and India. Illicit drugs and undocumented immigration are important issues, but they are long-standing, contentious problems that have mostly divided the United States from the region. The challenge for Washington is how to conduct a constructive and cooperative policy toward Latin America while the region remains a relatively low priority—and U.S. influence in the region is at a low ebb.

Washington's first task will be to demonstrate renewed respect for international rules and institutions. The United States cannot be seen as high-handed. It cannot claim the right to invade other countries preemptively or make decisions unilaterally against a consensus of other nations. The United States needs to play by the rules it wants others to follow. Second, Washington's policies, while serving U.S. interests, have to be more relevant to Latin America's own needs for faster and more stable growth, a sustained reduction in poverty and inequality, and progress against a seemingly endless wave of crime and violence.

What Latin American nations mainly want from Washington is greater access to U.S. markets, investment capital, and new technologies. The White House's most important challenge is to fashion a bipartisan approach to regional economic and trade policy.