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Attacking Poverty and Inequality in Latin America: The U.S. Can Help

Mr. Chairman, Members of the Committee: Thank you for the privilege of appearing before this Subcommittee on the Western Hemisphere of the House Foreign Affairs Committee.

For almost 20 years, most countries in Latin America have been implementing market reforms – opening their economies, privatizing their former state enterprises, and addressing their debt and fiscal problems. These so-called Washington Consensus reforms were supported and encouraged by the U.S. and the U.S.-backed IMF, World Bank and Inter-American Development Bank. They have beaten back inflation, increased capital inflows and investment, and contributed to modest growth. But relative to expectations they have failed on two counts. First they have not delivered the kind of hefty growth that is reducing poverty so dramatically in China and India. Though the rate of poverty (defined as number of people living at or below \$2 a day) has fallen slightly (to 40 percent), the number of poor people has been stuck for almost a decade at a shocking 200 million. Second, they have benefited the already rich and well-educated far more than the poor and middle-income majority. It is true that income inequality is increasing not only in Latin America but in China, India and Russia (and of course here in the U.S. as well). But in Latin America, income inequality was already extraordinarily high and visibly unjust (with for example the richest 10 percent of households capturing 50-60 percent of income) to start with.

The result has been deepening resentment —with market reforms, with the political process, and not surprisingly in some countries with the “capitalism” and globalization of which the United States is the dominant symbol. More than 60 percent of those surveyed in most countries are unhappy with the way their democracies are working (a 2006 survey), and more than 90 percent (in 2001) viewed the distribution of income in their country as “unfair” or “very unfair”. In this context, the election or re-election and the growing popularity of candidates representing the “left” broadly defined is not surprising. Some, including Lula in Brazil, Bachelet in Chile and Vázquez in Uruguay, represent the maturing of the democratically constituted political party system in the region. But that is not true of others. Chavez in Venezuela is an increasingly despotic populist who is destroying the legislative



and judicial institutions that once provided a check on abuse of power. The direction Morales in Bolivia and Correa in Ecuador will take is not clear – Morales is certainly vulnerable to Chavez’s oil-funded largesse and anti-American rhetoric. Like them, Umala who ran for President in Peru, and Lopez Obrador who very nearly won in Mexico were attractive to voters, despite their anti-American and anti-democratic rhetoric, who are fed up with the gap in income, influence, power and privilege between elite haves and majority have-nots.

For the first time in the last two or more decades, and in marked contrast to the situation in the 1990s, there is now a risk that several countries will become more statist and protectionist in their approach to economic policy. Worse with the spread of populist demagoguery there is the risk that the region’s democracies will founder. And Chavez’s willingness to use his oil spoils to buy new strategic allies in (and outside the region) is a larger problem for the U.S. Though it would be wrong to exaggerate his appeal in the region, he is clever and oil makes him rich, at least for now. His anti-American campaign raises the risk that unless the U.S. responds, some of its key allies in the region will see their domestic political position deteriorate, and the U.S. could lose their support on geostrategic issues and in the global battles against terror, drug trafficking, money laundering and other illicit activities. U.S. investors and exporters could also lose out, if more leaders try to satisfy voters with renationalization of industries and trade protection. The basic problem is that his ”model” of a more socialist system with more emphasis on the needs of the poor, for all its fundamental flaws, falls on grounds made fertile by voters’ growing awareness that their existing social and economic systems are fundamentally unfair.¹

What can and should the United States do about this situation?

Support “fair growth”

The reform agenda associated with Washington – the IMF, the World Bank, the Inter-American Development Bank, and the U.S. Government -- has not been wrong, but rather incomplete. Its focus on stability and competitive efficiency rather than jobs and economic opportunities left out the poor and the near-poor middle-income majority – the 80 percent or more of people living at or below \$10 a day.² To address their needs, the U.S. should

¹ Shifter, Michael. “Hugo Chavez: A Test for U.S. Policy.” A Special Report of the Inter-American Dialogue, March 2007 (http://www.thedialogue.org/publications/2007/spring/chavez_emb.pdf).

² On the low income of the middle-income majority, see Birdsall, Nancy and Rachel Menezes, “Toward a New Social Contract in Latin America,” Center for Global Development Policy Brief, 2004 (<http://www.cgdev.org/content/publications/detail/2837/>). See also Birdsall, Nancy, “From Social Policy to an Open-Economy Social Contract in Latin America,” Center for Global Development Working Paper 21, 2002 (<http://www.cgdev.org/content/publications/detail/2769/>)



encourage its friends and allies in the region to focus on what I and my co-authors of a forthcoming book on economic policies in Latin America call “fair growth”.³

Fair growth policies are pro-growth and pro-fairness – built on a “growth” foundation of sound fiscal and monetary policy and open markets, but also a “fairness” foundation of financial, social, tax and regulatory reforms that eliminate insider privileges and corruption and give Latin America’s non-elite “silent majority” economic opportunities they have never really had. This is not just about charity for the poor – the theme President Bush sounded on his recent trip. It is also about challenging current economic policies and practices that add up to a lack of opportunities for working class and middle-income people. It is in large part about creating good jobs and providing good education so more people can create and take good jobs. As many of you know, in much of Latin America, small businesses cannot easily borrow (to expand which would create more jobs) because the laws and courts prevent legitimate creditors from seizing collateral. The children of urban workers, especially if they are members of ethnic and racial minority groups, cannot get a good education because public spending is low due to tax systems that are depressingly complex and encourage evasion. Secondary school graduates cannot get a good job because onerous labor laws drive businesses to prefer investing in equipment rather than new hiring. And middle-income households cannot get a mortgage because banks make more money lending to governments (so President Bush’s announcement of support for housing finance was good).

Our fair growth agenda includes elements associated in the U.S. with the political right and the political left: such policies as hewing to fiscal discipline (to drive down interest rates and encourage job creation and small business investment); charging public university students from affluent households higher tuition; eliminating tax loopholes and attacking the tax evasion that keeps average effective tax rates of the wealthiest families as low as 10 percent; facing up to racial and ethnic discrimination; replacing labor laws that make layoffs so costly that hiring is avoided altogether with an adequate system of social insurance that is portable from one job to another; guaranteeing rights of association and collective bargaining while eliminating regulatory minutiae that burden businesses. In effect it consists of a legal, regulatory and tax and expenditure environment that looks like what we have built in the U.S. – flawed of course in many of its details and in its implementation, but fundamentally meant to be fair in its democratic foundations – because it represents the collective will of the people.

Explicit support by the U.S. for growth that is “fair” is also about signaling to the people of Latin America that we are not just interested in our own prosperity, but in theirs – and in a kind of prosperity in their societies that extends well beyond their business, trade and financial elites with which the U.S. government is still seen as primarily allied.

³ Birdsall, Nancy, Augusto de la Torre and Rachel Menezes. Fair Growth: Economic Policies for Latin America’s Poor and Middle-Income Majority. Forthcoming (visit www.cgdev.org) . Washington D.C. The Brookings Institution for the Center for Global Development and Inter-American Dialogue.



Some specifics

The U.S. has money – but not nearly enough to leave trade and immigration policy and soft power aside. Still I start with money for aid programs because aid may be the politically easiest tool to deploy.

Aid: Target U.S. foreign aid on new opportunities for the majority. The fair growth agenda has to be driven primarily by the businesses, civil societies and democratically elected governments of Latin America. But the U.S. can help with programs of aid that visibly create and increase opportunities for the poor and middle-income majority. The legislation being sponsored by Senator Menendez makes sense – to support a special facility at the Inter-American Development Bank (IDB) focused on improving economic opportunities and at USAID on support of health and education services. The IDB has launched a program called Opportunities for the Majority; U.S. support of a special facility there would give it a substantial boost. Resources needed to help governments beef up tax administration; design and introduce loan and scholarship programs to accompany tuition increases at universities; include systematic evaluation of targeted cash transfer programs that encourage families to immunize their children and keep them in school (Oportunidades in Mexico; Bolsa Familia in Brazil); catalyze creation of credit bureaus, and so on, are not huge. But small amounts outside the political competition for tight budgets do enable governments to take initiatives that are otherwise hard to initiate.

The amount of any new aid is probably less important than the vehicle new money can provide for aggressive support of justice and fairness. Even a doubling of current aid to the region (of about \$1.5 billion) would pale in comparison to the many billions Chavez is spending -- to buy Argentine bonds, provide cheap oil to Bolivia, build infrastructure in Central America -- and for that matter the \$100 billion or more the governments in the region spend themselves on health and education programs alone. (The original members of the European Union spent more than \$20 billion a year on transfers to Spain from 1986 to recently, and are planning to spend similar amounts in Poland in the next five years.) On the other hand, Latin Americans look to the United States as a land of opportunity and mobility, where a strong middle class demands accountable and honest, competent government (even if they are unhappy with our intervention in Iraq and narrow emphasis in their region on the drug war). Aid explicitly designed to create new economic opportunities and upward mobility for more of the region's people would be visible and smart.

Aid: Plan Colombia: How about 60 acres and a plow? The balance between military aid and fighting drugs in this large U.S. aid program needs to change. President Uribe deserves continued U.S. support; he has not tried to hide embarrassing facts about his appointees but has stayed focused on transparency and institution-building. However U.S. aid ought to be aimed at demonstrating to Colombian citizens an interest in building a more just as well as a more productive rural economy. That is best done by increasing support for



social services, rural development, and alternative employment. Congress should urge that U.S. resources be used to implement a serious program of land reform that provides public support for resettlement of displaced populations.

Trade: Go ahead with the imperfect FTAs. The Democratic majority should find its way to ratifying the free trade agreements negotiated with Colombia and Peru. The Congress should provide financial support (e.g. \$100 million) to monitor abuse and strengthen enforcement of countries' own labor standards, since the main problem in those countries is not unwilling governments but lack of enforcement capacity. These agreements, by locking in what has been preferred access to U.S. markets, are likely to create more jobs, especially for unskilled and semi-skilled workers – the have-nots. It is also the case that rejection of these negotiated agreements would not be seen in Latin America as a sign of support for labor or other rights in the region, but as a sign of a resurgence of protectionist sentiment in U.S. politics, and lack of support for the moderate, democratic governments that are fundamentally our allies.

Trade: Reinstate discussion of an FTAA. The U.S. should work with Brazil to reinstate discussion of a Free Trade Area of the Americas – which has been set aside awaiting agreement between the U.S. and Europe on agriculture.

Soft power: Ethanol, energy, the Farm Bill, etc. A Farm Bill consistent with the U.S. taking leadership on opening rich country agricultural markets would be seen in Latin America as friendly to fair growth. A reduction or elimination of the import tax on ethanol would be a good way to jumpstart discussions with Brazil on the FTAA. Any legislation that encouraged conservation of oil would bring down its global price and do more to combat Chavez' influence than any other conceivable step, as well as supporting democrats in Ecuador (and Iran).

Soft power: an immigration bill. Failure to complete balanced legislation including an arrangement for temporary worker immigration and legalization will strain relations with Mexico, will possibly undermine the still-fragile standing of President Calderon there, and will be resented throughout Latin America as a sign of growing U.S. insularity and peevishness. There are practical proposals for ensuring that temporary migrants have positive incentives to return home and that the governments of Mexico and other sending countries have incentives to take responsibility for their return.⁴

Soft power: Remittances. Congress should ask the U.S. Treasury to work with U.S. banks to reduce further the cost of remittance transfers and to develop savings, lending and

⁴ For specific proposals on how a bilaterally agreed system could work, see Lant Pritchett, *Let Their People Come: Breaking the Gridlock on Global Labor Mobility*. Washington, DC: Center for Global Development, 2006 (<http://www.cgdev.org/content/general/detail/10292>).



other banking products targeted to remittance-receiving households, particularly in rural areas (especially in Mexico, where U.S. banks have a large share of the market).

The IMF, the World Bank and the Inter-American Development Bank in Latin America's middle-income countries. In the last several years there has been considerable discussion about the role of these institutions, where the U.S. has historically had critical leadership and constructive influence, in the middle-income economies of Latin America. With interest spreads low, commodity prices high, and a generally benign external environment, emerging markets and middle-income countries have been building their reserves and borrowing relatively little from the IMF and the multilateral banks. On the other hand, many of these countries are in a double bind – of both high social and high financial debt. They have huge divides in income and well-being – a large social gap – but to retain the confidence of creditors (domestic and foreign) given the burden of servicing that debt, they sustain those high reserves and run large primary fiscal surpluses.⁵ Both involve substantial opportunity costs in terms of financial returns and social gains. They are more interested in attracting private capital, deepening their local capital markets, and reducing the overall risks of both sovereign and private borrowing than in direct borrowing (for example for health and education programs and water and sanitation). The U.S. Congress should ask the Treasury to examine closely the unrealized potential for the official international institutions to better serve the emerging needs of Latin America's emerging and middle-income markets, for example in the form of greatly reduced time and transactions costs in countries meeting minimal standards of good government; greater emphasis on guarantees and insurance and other risk-management products; expanded demand-driven technical assistance; and increased emphasis on technical assistance in such areas as social insurance, pension reform, reform of agricultural and other subsidy systems, municipal finance, and debt management – all with the intention of expanding the potential for the countries themselves to spend more and spend more effectively on social programs.

Mr. Chairman, this concludes my statement. I welcome any questions that you and other Members of the Subcommittee may have for me. Thank you.

⁵ See Kemal Dervis and Nancy Birdsall, "A Stability and Social Investment Facility for High-Debt Countries." In *Reforming the IMF for the 21st Century*, ed. Edwin M. Truman. Washington, DC: Institute for International Economics, 2006.