DEVELOPMENT, GROWTH, AND POVERTY REDUCTION IN LATIN AMERICA: ASSESSING THE EFFECTIVENESS OF ASSISTANCE

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DEVELOPMENT, GROWTH, AND POVERTY REDUCTION IN LATIN AMERICA: ASSESSING THE EFFECTIVENESS OF ASSISTANCE

Wednesday, June 28, 2000

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON THE WESTERN HEMISPHERE,
COMMITTEE ON INTERNATIONAL RELATIONS,
Washington, D.C.

The Subcommittee met, pursuant to notice, at 2:20 p.m., in room 2200, Rayburn House Office Building, Hon. Elton Gallegly (Chairman of the Subcommittee) presiding.

Mr. BALLENGER. [Presiding.] First of all, let me apologize to the people gathered here today. Every once in a while this place gets to be kind of a madhouse, and I am afraid this is that time of the year when everything we do doesn't satisfy everybody, and so we get three or four votes at a time, and we are spending your money unwisely just for a little while here. But this is a very worthwhile cause we have got going here, and I would just like to say that the chairman will be here in a minute. But this idea that we vote four votes and then we wait an hour and then we vote four more votes and wait an hour may continue up until the evening pretty late.

So we will go ahead and start this whole thing, and if I may, I will introduce Mr. Carl Leonard first, the Assistant Administrator, Bureau of Latin America and the Caribbean, USAID, and Secretary Schuerch, Deputy Assistant Secretary for International Development, Debt, and Environmental Policy, Department of Treasury. Mr. Leonard, if you would, fire away.

STATEMENTS OF CARL LEONARD, ACTING ASSISTANT ADMINISTRATOR, BUREAU FOR LATIN AMERICA AND THE CARIBBEAN, UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT

Mr. LEONARD. Thank you very much, Congressman Ballenger. I want to thank you for the opportunity to testify before the Subcommittee today, and as requested, I will direct my remarks to how foreign assistance programs managed by USAID are promoting the economic and social development of Latin America and the Caribbean and, in particular, how these programs are alleviating poverty. I ask that my full written statement be included in the record.

Mr. BALLENGER. Without objection.

Mr. LEONARD. The work that we do every day takes place largely outside the headlines, but we strongly believe that our goals—

drawn from the Summit of the Americas—will help achieve greater prosperity throughout the region.

As Ambassador Lino Gutierrez testified before this Committee earlier this month, perhaps the most important challenge to democracy in the hemisphere is poverty. He further noted, “While democracy is more widespread than ever, recent events remind us that democratic progress in the Americas is neither immutable nor uniform.”

Despite these challenges, we remain optimistic with regard to the future of the Americas. Latin America is making progress, and our U.S. foreign assistance programs are achieving significant results and thereby contributing to U.S. national interests in the region.

In contrast to the lost decade of the eighties, in which GDP per capita declined by nine percent, the economic reforms introduced in the early 1990’s have brought about a resumption of growth and a decline in poverty in much of the region. This improvement in the region’s economic fortunes followed a sustained reform effort by many countries aimed at enhancing the role of market forces and increasing the region’s integration into the global economy.

It is important to note that the largest poverty reductions in the 1990’s have occurred in the countries that adopted the reforms first. Chile, for example, almost halved the proportion of households in poverty. Other aggressively reforming countries also achieved major reductions, such as El Salvador and Costa Rica. Other countries have made more modest progress, while still others, chiefly nonreforming countries, have seen the proportion of households in poverty actually increase.

Until all countries can show sustained progress in attacking poverty, democracy in the hemisphere will neither be complete nor secure. Surveys have shown a strong correlation between income concentration and support for democracy. In countries with the most equitable income distribution in Latin America, more than 80 percent of the population believe that democracy is the best form of government, while less than 50 percent are supportive in those countries with the greatest income disparities.

The region’s democracies are finding that economic growth and the macroeconomic reforms that help generate that growth, while essential, are not sufficient. In addition, there is heightened recognition that good governance and positive social outcomes are mutually reinforcing. Good governance creates a predictable environment for firms and households to invest and increase their productivity. These improvements support both increases in income and improvements in social indicators, such as literacy and mortality.

Indeed, the countries that are succeeding today, having successfully implemented the first generation of macroeconomic reforms, are now carrying out second generation reforms, including rule of law, citizen participation, and anticorruption activities.

USAID’s core program in the region is based on achieving the objectives established in the Summit of the Americas, including strengthening democratic institutions, fostering open markets and expanded trade, and reducing poverty in the hemisphere. USAID contributes to increasing the income of households living below the poverty line through targeted activities that increase their productivity. These activities do three things:

First, they increase access and reduce barriers to services that the poor need to achieve their full potential, such as financial services, education and health care, land title and property rights;

Second, they seek to improve governance, accountability, and the enabling environment within which the poor work to assure that they have access to a level playing field, participate fully in the selection of governments, and have effective national and local government institutions;

Third, they assist countries in crisis prevention and mitigation.

USAID combats poverty through improved access to credit, particularly micro finance. We have learned that the chief obstacle to credit is not risk but the cost to the lender of administering small loans. In addition, the poor typically have few assets that can easily serve as collateral. USAID has long been a leader in funding innovative techniques to give the poor access to small loans on affordable terms that cover the full costs of the lending operation.

Over the past decade, we have seen progress toward adoption of policies governing property rights and access, which operate on market principles. Yet, today, much property is still not formally registered. Modernized registration systems are essential to creating a basis for commerce, services, and governance to reach down to the poor. More broadly, the same institutional reforms and systems that empower the poor to participate in markets are also critically needed to facilitate expanded international investment in the region.

USAID is leading the Summit initiative on property registry modernization. We are working with the multilateral development banks and other partners to increase transparency, decrease transaction costs, expand access, and improve the security of tenure.

The single most powerful tool for reducing poverty and improving equity in the long run is high-quality primary and secondary education. In most countries of the region, primary school enrollments now exceed 90 percent, but two serious problems remain. First, the quality of those schools is often deficient. Many schools lack textbooks and other basic instructional materials, and schoolteachers are often poorly trained. As a result, repetition and drop-out rates are unacceptably high. Our response focuses on management, curriculum, technology, and policy reform. Specifically, our programs promote decentralization, increased availability of textbooks, improved teacher training, and better testing and evaluation systems.

Latin America has made notable progress in health in the last decade. Declines in total fertility rates have improved the health status of mothers and their children. Decreased family size increases the probability that children will remain in school and will have access to health care. In the last ten years, mortality rates for infants and children under 5 significantly declined in the region, even in the poorest countries. USAID has helped countries improve water and sanitation, widen access to health services, and raise rates of vaccination coverage. With USAID's support through the Pan American Health Organization, polio has been successfully eradicated in the Americas, the first region in the developing world to do so.

Although HIV is still in an early phase in most of Latin America, the Caribbean region is the most severely affected, with some of the highest prevalence rates outside Sub-Saharan Africa. USAID is working to reduce cross-border HIV/AIDS transmission and is placing renewed attention in the countries in the Caribbean that are threatened by the HIV/AIDS epidemic.

Investments in governance have paid off significantly over the past ten years with the successful institutionalization of democratic processes, reductions in human rights violations, and peaceful transitions of power.

Over the past decade, USAID has expanded its support for rule of law. We have supported major constitutional reforms to improve justice systems, to provide access to justice, and to protect basic human rights. High levels of crime and violence affect all, and particularly the poor; therefore, USAID works with national and local governments and other U.S. Government agencies to develop the capacity to provide basic security and justice.

USAID is a leader in treating corruption as a significant development issue. Our missions have supported a variety of initiatives. These include automated financial management systems to increase transparency, civil society groups that monitor elections, and technical assistance to controller general offices to improve their ability to audit the use of public funds and to investigate cases of fraud.

The emergence of elected local government is an important trend in the consolidation of democracy in the region. Elected officials now run municipal governments in 23 countries, up from six two decades ago. USAID is helping to strengthen the capacity of local government to respond to citizen needs.

Since economic crises and natural disasters have a disproportionate and long-lasting impact on the poor, USAID and other donors are devoting increased attention to crisis prevention and mitigation. The impact of Hurricane Mitch on the poorest people in Central America underscores the importance of improved environmental management. Deforestation, unsound land use, and inappropriate agricultural practices significantly increase the vulnerability of the poor to the impacts of disasters. USAID's environmental programs, including park protection, forest management, small-farmer hillside agriculture, and watershed restoration, are helping countries reduce their vulnerability to natural disasters.

From 1988 until 1997, I served as USAID mission director in three countries: Costa Rica, Bolivia, and El Salvador. Each of these countries established coherent and growth-oriented policies, made a strong political commitment to change, and took advantage of USAID's targeted programs. Although no one would claim that foreign assistance is the determinant factor in their success, our programs in each country worked with governments and citizens alike to achieve significant results.

In Costa Rica, the stabilization and subsequent restructuring of the economy built on a foundation of long-term investments in education and health yielded economic growth with equity.

Bolivia experienced a dramatic recovery from the economic chaos and hyperinflation of the 1980's. USAID has played an important role in helping Bolivia to build institutions, strengthen popular participation, encourage licit crop production, and create alternative development opportunities.

For El Salvador, the 1990's saw the signing of the peace accords and policy reforms which ended conflict, achieved reconciliation, spurred strong economic growth, reduced poverty, and strengthened democratic institutions.

To continue these and other programs in the region, we will need the bipartisan support we have received for our programs. My written statement provides an overview of the fiscal year 2001 budget request. I also discuss priority areas, including Plan Colombia and completion of the reconstruction program for Central America and the Caribbean.

In conclusion, for democracy to flourish in the region, we need to sustain efforts to expand access, improve governance, and confront crises. Because of our close geographic, economic, and cultural ties, development and democracy in Latin America and the Caribbean matter greatly to the United States. USAID's field presence in 16 countries and our bilateral and regional programs are an integral part of U.S. foreign policy.

The nations of the hemisphere have set ambitious goals of greater prosperity, reduced poverty, and strengthened democracy. That will require an acceleration of growth and reduction in inequality. With sustained commitment, we know steady progress can be achieved. We look forward to working closely with the Subcommittee and Congress in the achievement of these shared goals.

Thank you.

[The prepared statement of Mr. Leonard appears in the appendix.]

Mr. BALLENGER. If I may, Congressman Menendez, I think you have got an opening statement, and I am sorry I started. Just go right ahead? OK. Secretary Schuerch?

STATEMENT OF WILLIAM E. SCHUERCH, DEPUTY ASSISTANT SECRETARY, INTERNATIONAL DEVELOPMENT, DEBT, AND ENVIRONMENTAL POLICY, UNITED STATES DEPARTMENT OF THE TREASURY

Mr. SCHUERCH. Congressmen Ballenger and Menendez, I appreciate the opportunity to discuss the central role that the World Bank and the Inter-American Development Bank play in helping the countries of Latin America and the Caribbean address their formidable economic and development challenges. In our integrating world, the United States has a growing stake in the economic and political stability and the success of Latin America and the Caribbean. The region is particularly important given our strong cultural, economic, and strategic interests as it accounts for 20 percent of both U.S. exports and U.S. foreign direct investment.

As we know from development experience, it is a country's own commitment to sound policies that is the most critical factor in its ability to improve the economic welfare of its people. When such a commitment is genuine and policies are sound, the World Bank and the IDB can provide valuable supporting roles in promoting sustainability economic growth, open markets, poverty reduction, environmental protection, and good governance.

At the same time, most Latin American countries rely far more heavily on private financing, and the multilateral institutions now provide only a small fraction of total resource flows. My colleague, Mr. Leonard, has provided a comprehensive picture of USAID's assistance programs in the region. AID and the MDB's share common objectives—promoting growth, reducing poverty, and improving governance—and they collaborate on the ground, with other donors and through consultative groups and other aid fora. There is a commonality between the MDB's and USAID in many of their targeted development priorities, such as addressing corruption, institution building, public participation, education, health, and, as we saw in the aftermath of Hurricane Mitch, economic reconstruction.

The MDB's are also active in promoting reforms in a broad range of areas which we often now take for granted. These include allowing markets, not governments, to set industrial, energy, and agricultural prices, liberalizing trade and investment, prioritizing public expenditures, professionalizing and shrinking civil services, reducing or eliminating public subsidies to public enterprises, privatization and allowing private firms to compete in all sectors of an economy, and reforming the banking sector through sound banking and credit policies.

I would like to provide a little bit of an overview of the economic and social situation—their major economic turn-around following the low decade of the 1980's. The 1990's saw important strides in implementing sound macroeconomic policies, adopting more outward-oriented and private sector-friendly environments, and improving public sector management. Despite individual country setbacks, there has been a major improvement in the direction of democratic and more accountable government.

Real annual growth for the region was 3.6 percent over the 1991–98 period. However, this amounts to only 1.1 percent per capita annual growth. This is a significant improvement over the 2.6 percent annual increase during the prior 15 years, but it is only an increase of 0.4 percent on a per capita basis during that period.

In 1998, growth in Latin America slowed to 2.1 percent and was virtually flat in 1999. Growth has subsequently rebounded, and the projected rate is roughly 4 percent for this year.

During the 1990's, growth was achieved against a background of financial crises, natural disasters, and fluctuations in commodity prices. The Mexico crisis in 1995, the Asia crisis in 1997, the Russia crisis in 1998, Brazil's financial instability in 1999, natural disasters of El Nino, La Nina, Hurricanes Mitch and Georges, and the mudslides in Venezuela we all remember.

Economic growth has also translated into important social progress. Infant mortality rates dropped from 61 per 1,000 live births in 1980 to 31 in 1998. Life expectancy at birth has increased from 65 years in 1980 to 70 years in 1998. Primary school enrollment has increased from 86 percent for males and 85 percent for females to 95 percent for males and 93 percent for female, from 1980 to 1997. The percent of the population with access to sanitation has increased from 46 percent in 1982 to 68 percent in 1995.

At the same time, much remains to be done. Economic and social progress has been uneven both within and among countries, and Latin America's record in translating economic growth into poverty reduction has been very disappointing.

Latin American countries have the greatest income disparities of any region in the world. The poorest 20 percent of the population receive less than five percent of total income while the richest 20 percent receive 53 percent.

More than 15 percent of the population are living on less than $1 per day; more than 36 percent are living on less than $2 per day. These shares have roughly remained constant, and perhaps have had only a slight decline over the past 10 years or so.

One of Latin America's most crucial development challenges is to do a better job in ensuring that efforts to promote economic growth, poverty reduction, and economic inclusion are mutually reinforcing.

In addressing this challenge, we know some things about the factors that contribute to equitable growth. For example, there is now a broad consensus on the need to focus explicitly on attacking poverty and by concentrating resources more effectively on interventions that most directly affect poverty. While it is crucial for the countries of the region to maintain sound economic management, they also need to give priority to investments in human development, particularly the provision of stronger and more efficient basic education and health services and rural development that expand opportunities for the poor.

I would like to turn to the roles of the two banks specifically. Because Latin America's per capita income is relatively high compared to other developing regions, only a small portion of World Bank and Inter-American Development Bank assistance—concessional assistance, that is—is provided to the region, roughly about $875 million annually over the past five years. This assistance is restricted to the region's poorest countries: Bolivia, Guyana, Haiti, Honduras, and Nicaragua.

The level of hard loan lending to Latin America normally averages about $10 billion annually. There was a substantial increase in assistance during 1998 and 1999 to a peak of about $16 billion in 1999 to cushion the financial and development impacts of the crises in particularly Argentina and Brazil. Lending has now returned to more normal levels.

Throughout the 1990's, in terms of net transfers instead of new lending, it is not unusual in some years for the Latin American region as a whole to have a negative flow, an outflow in repayments and charges vis-a-vis new lending, or in other years to see net flows roughly in balance.

The effectiveness of MDB lending to Latin America varies by country. Overall, we believe the World Bank and the IDB have played a highly positive role in encouraging and supporting countries of the region to build economic frameworks necessary to make markets work more effectively and allow private enterprise to grow.

I would like to use two examples of success stories in the region: Argentina and Bolivia.

Since 1991, when Argentina began a dramatic turn-around, Argentina has been the second largest Latin American borrower from both the World Bank and the Inter-American Bank. Over this period, in sharp contrast to its past stagnation, economic growth averaged five percent per year. Total GNP doubled in real terms, and the economy was put on a sounder footing to address outstanding problems, particularly a stubbornly high level of unemployment and the need to improve certain social indicators that have been deteriorating, such as income equity and poverty. The World Bank committed a total of $12.6 billion since 1991 in a program that evolved from support of public sector reform and privatization to support of financial sector reform, and then provincial reform, focused first on provincial finances and increasingly on provincial social sector issues.

The World Bank's independent Operations Evaluation Department recently reviewed the Bank's assistance strategy for Argentina. Its report is highly positive in terms of the total impact of the Bank's supportive financial and advisory role on a highly committed government. The overall strategy was judged largely successful, with high rates of achievement of project objectives and low levels of portfolio problems.

Bolivia is the largest recipient of aid to Latin America in both IDA's and the IDB's Fund for Special Operation concessional windows over the last decade. It has experienced a dramatic economic transformation also. Emerging from a period of severe economic and social chaos, Bolivia has compiled an impressive 12-year track record of stabilization and reform despite major economic constraints, including weak institutional capacity, major infrastructure weaknesses, adverse terms of trade, and vulnerability to climatic setbacks.

As is the case in Argentina, it is the strong commitment of successive democratically elected governments that has been decisive, although MDB's have provided crucial support. Annual growth in Bolivia averaged 4.3 percent, or two percent per capita, in the 1990's after recording negative growth during the 1980's. Inflation has been reduced from 24,000 percent in the mid-1980's to about five percent today. Privatization has reduced state-controlled enterprises from 25 percent of the economy in the early 1990's to less than two percent.

Unfortunately, the resulting impact of economic growth and reform on poverty has been modest. While most social indicators show improvement, some 70 percent of the population remain poor. The government is strongly committed to addressing this problem and is currently in the process of developing a Poverty Reduction Strategy Paper in the context of the World Bank's program and IMF's concessional program that will set clear strategies for addressing key constraints on reducing poverty.

The World Bank and the IDB will continue to support economic reform in Latin America, recognizing that many countries are now in the most difficult phase of the reform process—addressing major public sector reforms, pension reform, budgetary reforms, institutional and judicial reform, frequently at both the Federal and local levels—where implementation is complex and politically difficult and the efforts needed to build necessary domestic public consensus are time-consuming.

Future programs will also focus heavily on reducing countries' vulnerability to adverse developments in the international economy and financial markets, while concentrating even more assistance on social sectors.

Both institutions are also participating in the Heavily Indebted Poor Countries Initiative for some of the poorest countries in the region. The United States has played perhaps the leading role in helping to design and implement the HIPC Initiative, and the enhanced HIPC Initiative seeks to improve prospects for long-term growth and poverty reduction, by reducing debt for countries that have demonstrated good economic performance in order to provide a cushion against future debt problems and to free up significant new resources for productive investments to reduce poverty. Bolivia was determined eligible for enhanced HIPC relief in January; Honduras is expected to become eligible this July. Two other Latin American countries—Guyana and Nicaragua—are also on the list. HIPC is not a cure for the poverty of these countries, but it is one of several programs, including the provision of concessional IDA and FSO resources and USAID resources, focused on deepening long-term sustainable efforts at poverty reduction.

I should note the Administration request to help finance HIPC is pending before the Congress. Passage is crucial for the initiative as a whole, but particularly for eligible Latin American countries. I chaired a meeting last week among the IDB and its member countries where agreement was reached on how to finance the IDB's full participation in the HIPC. However, without a substantial U.S. contribution to the HIPC Trust Fund, debt relief for Bolivia will not occur. In addition, debt relief for other Latin American HIPC's will not move forward. With Honduras also expected to become eligible shortly, the need for a sizable U.S. contribution to the Trust Fund is urgent.

In terms of the annual funding appropriations, the cost for financing other World Bank and IDB operations in Latin America is very modest. We no longer request funding for either institution's hard loan windows because we believe the existing capital bases of the institutions are adequate to sustain their lending indefinitely. Budgetary costs attributed to IDA operations in Latin America are about $70 million annually. The latest replenishment for the IDB's FSO concessional window entails no additional commitment of new resources from the United States. The next replenishment is likely in the time frame of 2008.

This year's Administration request for appropriations for other World Bank and IDB developing countries' programs which impact Latin America total $76 million; $16 million is for the Multilateral Investment Guarantee Agency that provides investment insurance against noncommercial risk for private insurers and the major users of that program happen to be U.S. companies operating in Latin America; $34 million for IDB's Inter-American Investment Corporation, which provides long-term loans and equity investments in small- and medium-size enterprises, primarily in smaller and poor countries; and, for $25 million for IDB's Multilateral Investment Fund, which focuses on catalyzing investment reforms through grants for technical cooperation, human resource development, and small enterprise development as well as micro finance institutions.

In each case, I would note the amounts that are going through the budget process and actions in the House and Senate Committees are substantially lower than the requests that are before those Committees.

Like all institutions, the Bank and the IDB can both be improved and their capacity can be strengthened to respond quickly and creatively to evolving requirements of their membership. The Administration has worked hard with the members of the World Bank and the IDB and with their managements to promote reforms that improve their development effectiveness. We have been successful in achieving significant changes in many areas: more transparency and accountability in the institutions and their operations; increased attention to poverty reduction, greater attention to lending effectiveness and project quality, more focus on governance and anticorruption, increased attention to environmental sustainability and core labor standards. The reform program continues.

In concluding, Mr. Chairman, I would like to reemphasize that the Treasury Department remains committed to working hard with the management and members of the World Bank and the IDB and with the Congress to ensure the institutions are able to work effectively in supporting borrowing governments that are committed to sound economic management and reform. The challenge of reenergizing efforts to combat poverty in Latin America is a complex one and multidimensional. In a good policy environment, economic assistance—multilateral and bilateral—can and does make a significant difference in spurring growth and reducing poverty. We will work closely with the Congress to maintain a selective and well-targeted program in this area.

Thank you for your consideration, and I would submit my written statement for the record.

Mr. GALLEGLY. [Presiding.] Without objection, it will be made a part of the record in its entirety.

[The prepared statement of Mr. Schuerch appears in the appendix.]

Mr. GALLEGLY. Mr. Secretary and Mr. Leonard, I first of all want to apologize for the circumstances of today's agenda. I think everyone knows what is going on on the floor, and it is unfortunate but it is a part, I guess, of the process, or we would have more members here.

In the interest of time, I am going to ask unanimous consent that my opening statement be made a part of the record rather than me presenting it orally, and without objection that will be the order.

[The prepared statement of Mr. Gallegly appears in the appendix.]

Mr. GALLEGLY. At this point I would defer to Mr. Menendez, if you have opening comments or if you would just—whatever your preference is, Mr. Menendez.

Mr. MENENDEZ. Thank you, Mr. Chairman. I ask unanimous consent to have my full statement included in the record as well.

Mr. GALLEGLY. Without objection.

[The prepared statement of Mr. Menendez appears in the appendix.]

Mr. MENENDEZ. I just want to use parts of my statement to challenge both of you and the respective agencies that you represent. I had hoped to listen to testimony that would have dealt more—not only with what you dealt with, which was fine, but with our funding levels, and, what I consider to be ever increasing declining aid levels in the context of one of the most important regions to the United States on questions of trade, on questions of health, on questions of immigration, on questions of illicit narcotics trafficking, on questions of biodiversity, and the list is endless. While we speak in words that suggest to the hemisphere that we care about them and that we are interested in them, we act in different ways.

Clearly, if we want to seriously talk about long-term sustainable development, we have got to talk about investments in education, first and foremost, in health care, in property rights, in judicial reform and good governance. But if I look at the foreign assistance for the region, which is one of our primary tools for addressing these development issues, I see a drastic cut. In the 12-year period, the United States reduced its bilateral assistance to the region by two-thirds, from $1.8 billion in 1985 to $600 million in 1997. In 1988, Latin America represented 17 percent of total USAID programs, yet ten years later, in 1999, it represents only seven percent, from 17 to seven percent in a decade.

Let's put this in perspective. Latin America and the Caribbean countries contain more than one in six persons in the world's nations, yet it gets only seven percent of our aid. The region accounts for over 12.5 percent of the world's population, yet only seven percent of the aid.

Of those living in poverty in the world, nearly 30 percent of them live in Latin America and the Caribbean, yet, again, only seven percent of our aid, the overall purpose of which is to reduce poverty, goes to the region.

So I look at that, I look at the wealth and income gaps in the region, already the highest in the world during the 1970's, widened dramatically in the 1980's, the lost decade of no growth and high inflation, and have continued to increase even with the resumption of growth in the 1990's.

In part, clearly my concern and my questions to both of you and to the Secretary, only 18 percent of the IDB's total lending last year went for social needs, a decrease from the 24 percent lent in 1998 for these purposes. At the same time, total World Bank lending for social programs fell to $1.4 billion, only 19 percent of the total, from $2.6 billion, or 44 percent of the total, the previous year.

It seems to me that the challenge we face is to change our policies, which includes our resources to address poverty, not just simply drugs and immigrants. That is all we hear about here, drugs and immigrants. If that is the way we continue to speak to Latin America, we are not going to go very far.

People flee their countries because they are either mired in poverty or to escape civil conflict. Otherwise, those countries have enormous resources for people to stay in their own countries. We spent enormous amounts of money in Central America for war, and now when we have planted the seeds of the potential for democracy, we basically abandon it, leaving to their own devices the ability to move forward.

So we need to change our policies. We obviously need to create a constituency with Latin America, and that is why I propose—and I will be offering legislation—to create a development fund for Latin America. I hope my colleagues on the Committee will be supportive of it. I seek to create a floor, not a ceiling. I am tired of Latin America being the one location when there is an international issue that money is taken away from. It is already too little.

Last, I am very happy to see in the testimony that Professor Bradford will be offering before this Committee that he tells the Members of this Committee—and I would love to have him at some point before the full Committee that we could get some attendance at and they would listen—that, the concerns in terms of assistance, development assistance, he says in his testimony that in an internationally recognized report that recently was released, it demonstrates that progress—this is speaking about development assistance—that progress is possible. It shows convincingly how different elements of the international development assistance efforts under our review can achieve a reduction in poverty. It vividly demonstrates the concerted effort by both bilateral and multilateral development programs, the degrees of success they have. Finally, it says something that I totally agree with him on, which is that it is simply the case that the central issue in aid effectiveness today is aid volume, and we cannot expect grand results from meager investments.

With all due respect, gentlemen, listening to your testimony and reading through it as you were presenting it—AID, I am a great supporter of AID. It does what it can with what it has. But you just simply should be out there advocating much stronger for a greater part for Latin America, and the Administration should not be opposing Latin America development fund efforts so that we can finally match our actions to the words that we say to the people of the hemisphere when we bring them together in grand summits.

There is nothing worse than to defraud a people by giving them a vision of what is possible and then totally having a hollow response to that vision. That is really where I believe that we have been at with the hemisphere.

Thank you, Mr. Chairman, for your indulgence.

Mr. GALLEGLY. Thank you, Mr. Menendez.

Mr. Secretary, the IDB's eighth replenishment required that 50 percent of the projects funded be in the social sectors, including those of civil society and the environment. This has been a major challenge for the Bank. Can you give us an idea of how the Bank has met this requirement so far?

Mr. SCHUERCH. I am not sure, depending on what is classified as social expenditures. There is quite a bit of discussion as to all of the components that go into——

Mr. GALLEGLY. The subjectivity of——

Mr. SCHUERCH. Yes, the subjectivity of classification schemes is an interesting discussion, actually, but we have called for, as you have said, 50 percent in the eighth replenishment. In the World Bank, on the other side, we have called for 40 percent of lending to go into the social sector. Both of these are major shifts, and I would say in both cases we probably have statistics, although I haven't seen precisely the ones you are quoting, that show them trailing what the aspirations were in the international agreement.

Certainly I have seen that in the World Bank, and certainly in totals. I don't think on a disbursement basis you would see 50 percent of the IDB numbers either. They have very definitely, not just at the Bank but in the leadership of the individual countries, come to a consensus that there needs to be substantially more effort and more investment in the social area, particularly education and health. But the numbers, I believe, have yet to fully catch up with the aspirations and where leadership is.

Mr. GALLEGLY. I appreciate the fact that there is some subjectivity to the issue of social expenditures, but there is certainly no question about the spirit, and certain areas that clearly, as you mentioned—education, health, things of that nature—fit in that category. But it doesn't seem like we are getting anywhere.

Mr. SCHUERCH. We are in agreement with the tenor of your remarks, and we have continued to push on this. Where there is marginal disagreement on classification it is more in the infrastructure areas, which elements of infrastructure, roads and other things, or schools, can be counted in the social area.

We continue to push on the social sector and on increasing it. The Secretary's speeches at the Annual Meetings have also pushed on this. There is improvement in the IDB. The IDB took up the poverty alleviation theme and the focus in its programs before any of the other institutions. But we are not at a 50 percent level at this point.

Mr. GALLEGLY. On page six of your testimony, you provided a warning on the region's political and, I think you said, economic vulnerability, and I don't think that is anything that we disagree on. You also say that the World Bank and the IDB will concentrate even more aid on the social sectors.

Is it fair to say that the IDB and the World Bank will consider increasing its assistance to the region or just redirect existing efforts to the social sector?

Mr. SCHUERCH. I think every dollar the IDB has is for this region, obviously, so it is not a question of an increasing pie in that particular instance. So there it is clearly redirection.

I think within the World Bank it is redirection as well, but there is a difference in the World Bank in that in the concessional program, the IDA Program, we now have in place under the last replenishment a performance allocation structure. So countries are judged on how well they are investing the money they are getting from the institution, how well they are running their portfolios, their economies, and on corruption issues and governance issues. So they get an allocation that is based on a judgment about how well the resource they would receive will be utilized. That judgment is made on an annualized basis, so a country in a sense earns its allocation under the IDA program. Latin countries can improve their performance, and they will get more resources as they improve their performance. This applies to every region. So it is not a top-down direction of more resources in that case.

In terms of the hard loan windows, it is performance-based as well as demand-based. The countries themselves need to make a judgment about the amount they want to borrow. Many of them can borrow on the private markets at a lot closer to the interest rates they can get from the World Bank or IDB, so it is not solely a judgment of need as to how much they choose to borrow from institutions. Neither institution is fully constrained in terms of its total resource levels today. There is headroom for additional lending.

Mr. GALLEGLY. Mr. Ballenger?

Mr. BALLENGER. It was strange to listen to both of you deliver your testimony, and nobody mentioned the effect of, first of all, losing NAFTA, having its original effect on the Caribbean area, and then I just happened to be in El Salvador when they announced that CBI was going to—that the Senate and House had agreed—it hadn't passed yet, but the Senate and House had agreed, and I was talking to a manufacturing gentleman there that was looking for 1,200 people immediately. Contracts were coming so rapidly that he needed to hire 1,200 people immediately.

In fact, I heard the Presidents of Nicaragua, El Salvador, and Guatemala say, your aid is wonderful and all this kind of stuff, but if you get a CBI, we would rather have that than anything that you can do for us. It really is kind of strange that neither one of you mentioned it.

Second of all, especially as far as the banks are concerned, I know I have discussed with the President of Nicaragua and other areas down there the fact that most of their banks are so small that if you really wanted to be able to develop anything down there—and I am not knocking the social. I think jobs are almost a very important part of the social structure. I don't know what you can do about small banks that can't lend very much money. It is one of those things. We don't know how you solve that, to be honest with you. Do you have any—especially in the banking business, do the banks borrow money? Who borrows the money? Does the country borrow the money or do the banks borrow the money? Who borrows the money?

Mr. SCHUERCH. Which money? If you are talking about IDB money or World Bank money, it requires in the case of the World Bank a sovereign guarantee, and in most of the cases of the IDB, a sovereign guarantee also.

In terms of lending to small- and medium-business enterprise, both banks have private sector windows: one, the International Finance Corporation in the World Bank, does somewhat larger operations, but has a major portion of its business in Latin America; the Inter-American Bank has the Inter-American Investment Corporation, and we have just completed last year a replenishment for a ten-year period, $500 million, and it is targeted more at the types of countries I think you are focused on at the moment, which is the smaller countries, the poorer countries, because many of the large ones, even though they have large percentages of the poor population, in fact have internal resources that are quite consequential. Brazil and Mexico both have development programs that are internal and that are large. I think Brazil's exceeds the size of the IDB's lending program, for example.

Mr. BALLENGER. What I would like to say to the U.S. AID is, having seen your operation for the—what do you call it? It is not small loans, but small businesses that they had. First I saw it in El Salvador. Then I think your manager that you had in El Salvador moved to Nicaragua, and both of them, as far as I could see, I have never seen a young girl who started off with $50 worth of goods in Nicaragua and had built it up to where she had a fairly nice little size area of—kind of a shopping center of groceries and things. To my way of thinking, when you can see the pride that was developed by those people in that whole general area, I commend you highly for that. I also commend you for the ability to—when you really go out in the boon docks and you see those poor people that don't know how to feed children and you have that program with corn and oil and a mixture and so forth and you teach the mothers how to feed the children, I am very happy with what you do.

I can't understand how we have cut—did we do this or did you do this, the amount of money?

Mr. LEONARD. Let me just say, Congressman Ballenger, I was in El Salvador and I remember well some of your trips to the region, and we greatly appreciate the interest and support you have given to Central America and the Caribbean over the years. When I was in El Salvador, we were supporting the peace process and economic reforms, and I remember some of those trips to the micro finance programs we put in place, and then your later interest and the support after the hurricanes to get the reconstruction assistance going. So we very much appreciate that, and we do feel we have made excellent progress.

You are right to mention the importance of trade and CBI enhancement. That is critical for the region, and it is a manifestation of the bipartisan support that we need to move the region forward, the passage of the CBI enhancement. We have worked in Central America, we are working in the Caribbean to enhance competitiveness, and that is very important for getting the growth we need. We need both growth and we need the poverty reduction programs to go forward concurrently.

In terms of the cuts, the cuts have been with us for a long time. Congressman Menendez pointed out where we were back in 1990 and where we are today. It has happened in a context of budget constraints that we all know about. The Agency for International Development worldwide has fewer resources today than we had in 1990. Along with that, programs in the region have also been cut.

I would hope that we in the Administration, Congress, the American people, we could build a consensus for greater volumes of foreign assistance, and with that there would be greater volumes for Latin America. But in response to the question could we use more resources, are there needs for more resources, the answer is clearly yes. I hope we can work together.

Mr. BALLENGER. Just one more question, and you can have it, but our friends there say, it is strange how, if we have a war in our country, Congressmen by the—gobs of Congressmen keep coming down here to see us and money flows, mostly giving us bullets and guns and stuff. But as soon as the war is over, everybody disappears. It is kind of a strange situation.

You wanted to go ahead?

Mr. SCHUERCH. Yes, I thought I would give a contribution. I maybe don't look that old, maybe I do, but I go back far enough that I remember the first CBI, the Caribbean Basin Initiative, and it was the early 1980's, not the current CBI you are referring to. I would say the high point of the total foreign aid budget—at least in terms of the Foreign Operations Subcommittee, I spent 14 years on the Appropriations Committee staff here—was in fiscal year 1985, during the Reagan years. Since that time in net present value terms, in real terms, it has been decreasing not every year, but virtually every year. There have been a few years with a plateau and a couple of upticks. That 1985 bill was about $18.5 billion compared to a bill today that is in the range, in nominal terms, of $13 billion or so, $12 billion to $13 billion. That bill only grew last year because of a Presidential veto, because it was substantially cut, and I think a couple billion was added back in the process late last year after the veto.

That cycle has been constant, and it has been constant regardless of executive/legislative control in terms of the party structure.

Mr. BALLENGER. Could I do it this way?

Mr. SCHUERCH. Do it your way. That is fine.

Mr. BALLENGER. It looks like growth from this——

Mr. SCHUERCH. It seems we have a dynamic that, for better or for worse, certainly needs to be reversed. The way you pass a bill in the House specifically is by cutting a foreign aid bill. People need to work together. In a shrinking pie, every region is squeezed, and some are squeezed less than others, obviously, and Latin America has been caught in quite a difficult circumstance.

Mr. BALLENGER. As you might gather, foreign aid is not the thing you win elections with back home. Somehow in the election years, it gets shrunk back.

One thing I would like to ask, because it was brought up, about the population, the growth in poverty in areas almost across the board it appeared coming up, and I was also wondering if the birth rate in this particular area could have some effect on—I keep thinking of Brazil where all the kids seem to be—you read about them all the time. We said something, a large percentage of the whole growth in that was in Brazil.

Mr. SCHUERCH. Yes. It is not just the birth rate. It is also life expectancy. People are living longer. Improvements in health result in longer life expectancy. You have a population growth that reflects both birth rate and longer life.

But the population growth rate has been consistently declining for the region. In the 1970's, you were up around an average of 2.2 percent, obviously with some countries quite a bit higher than that, but in the 1990's, we are down to 1.5 percent. The replacement rate is about 1.2 percent.

Mr. BALLENGER. When your population gets to be 500 million people, the percentage of growth doesn't take much to create a New York City every year. What is the actual—does anybody have a number for the actually——

Mr. SCHUERCH. I don't have the fertility rate, or desired family size.

Mr. LEONARD. I don't have the aggregated numbers for the region, but birth rates have been declining, and that correlates very closely with improvements in infant mortality, child mortality. As the birth rate declines, as child spacing has occurred, things have improved. The total population of the Latin America and Caribbean region reached $515 million in 1999. The growth rate is now an estimated 1.53 percent, down from 2.5 percent in 1970. Countries where population growth rates exceed two percent include Haiti, Honduras, Guatemala, Nicaragua, Bolivia, and Paraguay.

Mr. BALLENGER. I appreciate it because it would make a fair amount of sense. One thing I would like to say before I shut up is I have been trying to tell my friends down there that the education system is going to be the basis for whatever happens, and when Intel decided to pick a place in the world to locate their big assembly plant and they picked Costa Rica, I talked to people with Intel, and the pure and simple reason they located in Costa Rica was, peace, but the education system was so much better than any of the other ones. If somebody could somehow pass that word down there, put more money into education and less into whatever they are trying to put their money into.

Mr. LEONARD. I agree fully, Congressman. Costa Rica is an excellent example of the importance of investments in health and education over a sustained period, of developing human capacity, and they have achieved both growth and equity as a result.

Mr. SCHUERCH. I would say in some cases it is not just the amount of resources for education. It often also is how you utilize the resources. In many cases, when you look at education budgets—because this is an economy and a region that is upwards of $2 trillion a year, a little bit short of that for the region. There are lots of internal resources, although many countries, smaller countries are quite short—you will find that there is significant money being spent on education, not an inappropriate level, but it is being aimed at higher education, university education, and it is not being aimed sufficiently at primary education where there have been has improvements in terms of enrollment, or secondary education. One has to focus now on improving quality as well.

Mr. BALLENGER. I would like to say one thing. Venezuela, with all of its oil wealth and so forth, the lower grades are not particularly interested as far as their government is concerned, and I agree with you 100 percent. The money could be wisely applied to trying to develop the lower class into some educated people since they have such a large number of people that are in poverty.

Mr. GALLEGLY. Thank you very much, Mr. Ballenger. Thank you, Mr. Secretary and Mr. Leonard. Again, I apologize for the tardy start. It is going to continue to be a long day for all of us.

Mr. BALLENGER. Those of you who would like to stick around until late tonight, we will still be here.

Mr. GALLEGLY. I found it kind of amazing. Many of my colleagues today are coming to me, and probably you as well, asking have you heard whether we are going to be in on Friday? We are not really going to be here Friday, are we? I said, it depends on the action of some of you that are asking the question. It may be Saturday, it may be Sunday, it may be Tuesday.

Anyway, thank you very much, gentlemen.

Mr. SCHUERCH. Thank you, Mr. Chairman.

Mr. LEONARD. Thank you.

Mr. GALLEGLY. Our next panel is Dr. Colin Bradford and Ms. Sylvia Saborio, if they would come forward.

Our next panel is Ms. Sylvia Saborio, who is a senior fellow at the Overseas Development Council, and Dr. Colin Bradford, Professor of Economics and International Relations at the American University. Welcome.

Ms. Saborio, if you would like to make your opening statement, we look forward to hearing from you.

STATEMENTS OF SYLVIA SABORIO, SENIOR FELLOW, OVERSEAS DEVELOPMENT COUNCIL

Ms. SABORIO. Thank you very much.

Mr. Chairman, first of all, let me thank you and the Subcommittee for inviting me here this afternoon. I welcome the opportunity to discuss development assistance effectiveness in the context of our hemispheric partnership. Let me just say before I begin, that having heard what was said here today, I am very proud to acknowledge that I am Costa Rican.

My presentation will start with a synopsis of the state of development in the Latin American and Caribbean region at the turn of the century. I will then discuss some of the major challenges facing the region in the years ahead and consider ways in which external actors can help the countries in the region effectively meet those challenges.

At the risk of oversimplifying the regional picture by abstracting from the tremendous diversity that it contains, in the interest of time, I shall focus instead on the common threads that characterize the region at the turn of the century.

First, the rate of economic growth has been sluggish in comparison to world patterns. Average per capita income is currently around $3,100—less than a third that of industrial countries and lower than that of East Asia, the Middle East, and Eastern Europe. This wasn't always so. At mid-century Latin America's per capita income was higher than that of all other developing regions and half that of industrial countries.

Second, despite great strides in taming inflation in recent years, the region remains more volatile than other areas in terms of unemployment, job insecurity, and real income variability. Indeed, the growth rate in any Latin American country typically fluctuates four points in either direction in any given year. People who have not experienced such a roller coaster must find it hard to fathom how anybody can live with such insecurity and vulnerability. The answer is, of course, not very well.

Latin America also has the worst distribution of income in the world. A fourth of national income goes to only five percent of the population; the corresponding figures for Southeast Asia and developed countries are 16 percent and 13 percent, respectively.

In contrast, in terms of the United Nations Human Development Index, Latin America is on a par with East Asia and Eastern Europe and surpassed only by industrial countries, and this gap has been narrowing over time. Indeed, the region has made important strides in the area of health—issues such as the eradication of polio—and also registered some modest gains in education. It has entirely closed the gender gap, although it continues to have some problems in terms of quality and incompletion, especially at the secondary level. This, of course, fits right back into the lack of economic opportunity.

In terms of social development, another paradox: Latin America has moved to the forefront of the developing world in terms of civil liberties and respect for democratic rights, but individual violence has skyrocketed and crime rates today are higher than those almost everywhere else, except Africa.

Finally, the initial enthusiasm with democracy has begun to erode on the face of disappointing economic and social outcomes. While democracy has increased people's freedom to criticize unresponsive bureaucracies and inefficient spending, it has not necessarily helped to solve those problems; nor has it succeeded in stemming new threats, such as terrorism, corruption, and gun and drug trafficking.

It is clear from the mediocre record of accomplishments noted above that the region faces major challenges in the economic, social, and political spheres.

In the economic sphere, the so-called first generation of reforms—that involve things like import liberalization, opening of the capital account, domestic financial liberalization, privatization of public enterprises, and tax reform—have produced outcomes that fall far short of expectations. A recent study by the Economic Commission for Latin America concluded that, "Overall, . . . the reforms have had a surprisingly small impact..a small positive effect on investment and growth and a small negative impact on employment and income distribution . . ."

They found that the reforms did not solve, and quite probably increased, two problems: that investment continued to be concentrated among large enterprises that have few linkages with smaller firms, and that supplier chains were destroyed by increased imports.

They also found that the majority of foreign direct investment actually went to purchase existing assets—either through the privatization of public firms or takeover of private firms—rather than creating new assets.

Clearly, then, the next generation of reforms must be more pro-growth and more pro-poor. At the macro level, stability needs to be consolidated and the resource allocation improved, and at the micro level, the tendencies toward polarization and concentration have to be constrained, if not reversed.

In the social sphere, there are at least three areas where further action is needed. The first is, as Mr. Ballenger mentioned, employment generation. Employment has been squeezed on two fronts. Recent shifts in relative prices have favored capital-intensive production and import competition has wiped out a host of small, relatively labor-intensive producers. The "informalization" of employment is not a socially desirable option. Alternative employment opportunities in the formal sector must be developed. In this regard, affirmative actions to create an environment where efficient, small production units can thrive is the most promising way to generate employment and improve the primary distribution of income.

Second, social spending. Latin America has a lot of catching up to do in terms of human capital accumulation. Ensuring greater and more efficient social expenditure, especially in education, must be a priority. Mechanisms must be found to improve the delivery and financing of social services in ways that do not segregate access and quality according to social strata and that protect social expenditures from cyclical downturns.

Finally, social protection. In a region subject to as much volatility as Latin America is, safety nets are simply a necessity.

Last, but certainly not least, in the political realm, issues of governance and institutional development are a major and urgent challenge. Indeed, in my view, this is where Latin America has the greatest deficit.

Far-reaching institutional reforms are needed to enhance both economic efficiency and social equity, as well as to facilitate the interface with others in the hemisphere and beyond, in a rapidly globalizing world. This is a societal issue that transcends the government itself. In the public domain, mechanisms for decision-making, conflict resolution, and accountability need to be improved and the institutional capacity to carry them out enhanced. In the corporate sector, socially responsible entrepreneurship must replace the clientelistic, rent-seeking behavior of yesteryear. Civil society must find a coherent voice and a constructive role to play in this new scheme of things.

Now, while Latin America must remain the main protagonist of its own development, external actors can and should play an important supporting role, basically in three areas:

First of all, by providing an enabling environment. Now that the region has embraced an outward-oriented, market-based development strategy, open markets and a stable international financial system are critical to its success.

U.S. leadership is essential in this regard. On the trade side, it should secure fast-track authority so that it can engage in serious negotiations with regional partners toward the completion of the FTAA by 2005, and so that it can credibly push for global trade negotiations in the WTO—here I would like to acknowledge the recent passage of the CBI legislation which, for the countries in the Central American and Caribbean regions, will provide increasing opportunities in the trade area. On the financial stability side, the U.S. should bring its considerable weight to bear on the G–7 and on the IMF in order to improve both the mechanisms for crisis prevention and for crisis management. The U.S. should also weigh in on the private financial sector to improve risk management practices and exercise corporate responsibility.

The second is the area of development finance. Meeting the region's hefty needs in terms of physical, human, and social capital is going to require the mobilization of considerable resources, both from domestic and external sources. The particular resource mix needed will vary widely from country to country, depending on size, stage of development, and particular circumstance. But in most countries, public funding is still needed to crowd in private funding.

The IDB and the World Bank have important roles to play in supplying some of those funds. Recent analyses suggest—and my own experience with both of these institutions confirms—that there is vast room for improvement in the way they perform their development finance function. In my view, this is true of the way they allocation their corporate resources and their loan portfolio, as well as of the way they handle the project cycle. Corporate incentives are skewed in favor of loan approval, and partly as a result of that, especially smaller borrowers tend to get short shrift in terms of the allocation not only of funds but of high-quality personnel. These are not arguments for closing down these institutions but, rather, for improving them. To be fair, the mounting criticism is beginning to have an impact. I myself am not a great believer in the Comprehensive Development Framework and the way it is being applied: I find it a bit too grandiose, involving too many actors, and prone to overload existing institutional capacities. But, clearly, some organizing principle is needed to set development priorities and see to it that they get financed. Time will tell whether the CDF is the answer. . . or the problem. I have similar misgivings regarding the poverty reduction strategies that are being linked to the HIPC Initiative.

Second, there is the area of bilateral development assistance, which also has an important role to play in some countries in the region. Clare Short, the British Secretary for International Development, recently declared that the European Commission is "the worst development agency in the world." That may be so, but it has company.

A study of USAID I recently conducted led me to conclude that the system of resource allocation is vastly over-determined; it is micro managed in myriad ways rather than obey a strategic concept, and this I have to say largely reflects the many ceilings, floors, and earmarks imposed by the Congress itself. But the effectiveness of U.S. development assistance is further compromised by the fact that a large portion of U.S. bilateral aid is tied: three-quarters of it versus just one-quarter for the Development Assistance Committee as a whole. A recent World Bank study concludes that tied aid reduces the value of development assistance by some 25 percent. Last, but not least, of course, is the fact that at 0.1 percent of GNP, the U.S. has the lowest development assistance ratio in the DAC. This I find unconscionable at a time of unprecedented prosperity.

[I have brought some material from my colleagues at ODC who have done an immense amount of work in this area, but in the interest of time, I will not read it.]

Finally, a very important component of the development assistance package is not money but ideas. Here we need to be creative and eclectic. Development paradigms come and go, but in the process, they affect real people. We need more research and more technical assistance to share best practices and best policies more widely and, in so doing, reduce the overall cost of development.

In closing, I would like to thank the Subcommittee for this opportunity to share my views and concerns regarding Latin America and at the same time make an appeal to give the region more than the intermittent attention it usually gets, except for such perennial issues as Cuba, drugs, and immigration. After all, Latin America is already the U.S.'s most important trading partner, accounting for 45 percent of U.S. exports and 36 percent of its imports. We are engaged in the process of creating the largest, and hopefully most prosperous, partnership in the world. We know that development assistance works best within a strategic long-term framework. The framework for hemispheric cooperation is already there, agreed at the Miami and Santiago Summits. Now all we have to do is make it happen!

Thank you.

[The prepared statement of Ms. Saborio appears in the appendix.]

Mr. BALLENGER. [Presiding.] Yes, ma'am, I liked your finish there.

Dr. Bradford?

STATEMENT OF COLIN BRADFORD, PH.D., PROFESSOR OF ECONOMICS AND INTERNATIONAL RELATIONS, THE AMERICAN UNIVERSITY

Mr. BRADFORD. Thank you, Mr. Ballenger. I appreciate your patience and endurance. I think one remark I would like to make before I begin is that I think it was impressive, really, the number of people that were in this hearing room for the first hour and a half or so.

Mr. BALLENGER. Again, I apologize.

Mr. BRADFORD. No, I think that was a good sign, and as a couple of people have remarked, the number of people that were here were mostly younger people. That is, a very good sign to have a hearing on the Hill in which the next generation is showing some considerable interest, and I just would like to remark on that.

I would appreciate it if you would agree to put my written remarks in the record.

Mr. BALLENGER. Without objection.

Mr. BRADFORD. Thank you. I would like to follow on Sylvia's excellent presentation and just make a few remarks to you. Sylvia just said a very important thing that actually goes to the heart of the contribution that I wanted to try to make to your thinking, and that is, she said there needs to be some organizing principle to set priorities. As I sat here and listened and tried to put myself in your shoes, listening to the excellent presentations by Carl Leonard and Bill Schuerch, I realized the welter of detail that is being thrown at you in 12 minutes and the difficulty there is in trying to understand what in the dickens this is all about, and how can we get a handle on it so that we can tell whether we are doing what we should be doing and whether we are effective in achieving the goals that we have.

The international community has made more progress in this area, I think, than is generally realized. I brought with me—and you may have it in front of you—a copy of this report that was just issued on Monday. It is called "2000: A Better World for All; Progress toward the International Development Goals." This is an unprecedented report which is published and signed by the—I have extra copies here if you need one.

Mr. BALLENGER. OK.

Mr. BRADFORD. This is signed—I am told that this is the first document ever signed by the heads of the United Nations, the World Bank, the IMF, and the OECD together.

Mr. BALLENGER. Sounds like a put-up job, doesn't it?

Mr. BRADFORD. No, I think—I was afraid you might think that. I think what it shows is a great deal of coordination and common purpose behind these institutions, and let me tell you a little bit the story of what this is really all about.

In the period after the former Soviet Union collapsed, there was a concern that the whole aid business was going to simply disappear and that all of us who have been concerned about development, had a problem of communicating with our parliaments and congresses and our publics about what, in fact, the enterprise was about. So there was a long process that was begun in the DAC, the Development Assistance Committee, which Sylvia and others have referred to, which is the coordinating body for bilateral donors but in which the World Bank, the UNDP, and the IMF are observers. There was a year-long process which got going to discuss what kind of vision do we have now in the post-Cold War period, and this involved senior people in agencies and ministries of development and cooperation throughout the OECD world, and it involved the ministers themselves and heads of agencies, like our own Administrator of AID. In fact, Brian Atwood at the time was very involved in this.

What happened was we came out with, the international community came out with, after a long discussion, six goals which I guess I—if you have the single-spaced version of my testimony before you, it is on page 3. If you have the double-spaced version, I will steer you somewhere else. But the goals basically are—the primary goal, the first goal, and certainly the most important one, is reducing by half the proportion of people in the developing world living in extreme poverty by the year 2015. So the reduction by half of the proportion of people living in extreme poverty by 2015 is certainly the most important one and the one that is most relevant for the topic of this hearing.

But, of course, you just aren't worried about people's incomes. You are worried about their health, their education, their environment they live in and so on. So the rest of the goals are: achieve universal primary education, reduce mortality rates for infants and children, reduce maternal mortality rates, demonstrate that progress toward gender equality and the empowerment of women, especially in primary and second education, provide access to reproductive health services—one of the questions that you asked earlier on about population growth rates and the management of family planning—and then an environmental objective which is to put in place national strategies for environmental improvement to reverse the deterioration in resource sustainability in countries by 2015.

Then a quite important one that is not quantifiable is the idea that democratic accountability, protection of human rights, the rule of law, of course, are fundamental to achieving these goals, but is not so quantifiable as to be able to be monitored in the same way that these other goals can.

This report, which was issued on Monday, this week, in Geneva by the four international organizations in the followup to the Copenhagen Social Summit, what this report does, as you flip through it, you can see it takes the seven goals and it follows the progress of each region toward those goals as we go toward the year 2015, which is the target date for most of the goals.

I have reviewed for you here how Latin America is doing on page five, but Sylvia and others have already mentioned that. But I think the thing I would like to bring to your attention is more the process of this than the content. The process is that these goals were distilled out of the many hundreds of recommendations and goals that came from the U.N. Summits that began in Rio and on through five or six summits on various issues like the environment, population and development, women, human rights, et cetera. It distilled off only seven of these. They are quantifiable goals. They relate to each other and reinforce each other. So it is, a strategy. It is, to use Sylvia's word, an organizing principle. It is an organizing principle to set priorities. It is a strategy that the development community now has, and the significance is, I think, severalfold.

First, these are priorities which are established by governments. These were not generated by a think tank somewhere or even by the international organizations themselves. They came out of the summits, which meant that the political leadership in countries approved of them.

Second of all, they were endorsed by not only development cooperation ministers but also finance and foreign ministers of OECD countries in the OECD Ministerial in 1996, but more importantly, became prominent in the communique of the Denver G–7 summit and even more prominent under British insistence in the Birmingham summit in the U.K. in 1998.

So these have political salience, then, and they aren't just technical things that come from the development community, but these came out of a political process by people who were political appointees or elected officials in the cases of heads of state.

Furthermore, since they came from the U.N. Summits, they have involved also the developing countries, so that the developing country leadership has also been—it isn't as if this was something that was generated by industrial countries to foist on the developing world; rather, they had agreed to these as well, and in the Development Assistance Committee, there was a considerable effort in the course of developing this strategy to include leaders from the developing world as this process went forward.

The second thing that I would like to point out about this is that it has become a strategy for development agencies, both bilateral and multilateral, all around the world. The importance of this report is that this demonstrates that the UNDP and the other U.N. agencies, the IMF—in his concluding speech in the IMF/World Bank this last fall, Michel Camdessus handed everyone a card that had the seven pledges, the seven goals on it, and to have the head of the IMF, which is criticized roundly for not caring about the environment, not caring about social matters, having the head of the IMF be handing out this card for everybody to see how important he thought these goals were, he featured it in his speech at the Bank/Fund meetings.

The World Bank is thoroughly behind this. They have a staff of people that generate now a World Development Indicators Report, which began in 1997 after the goals were established, which reports annually in the framework of these targets.

So what you have is the multilateral institutions and the bilateral donors are on the same page, so that we are all going now for the first time ever in the aid effort in the same direction, bilateral donors and multilateral donors, NGO's are aware of this, private sector groups are aware of this strategy. We have a unified strategy.

The third element of it which I think is important from the point of view of your concern in this hearing is that because these goals are quantifiable and because the World Bank and the group of agencies that are represented in this report are together in doing a statistical monitoring of progress toward the goal, so you can tell, so the world community can tell, are we actually progressing or diverging in terms of achieving the goals—are we making progress or are we not? Do we need to do more or can we let up?

There was some discouragement, for example, in 1998 after the Asia crisis, those indicators went backward. But the point is we had benchmarks so we could tell and we didn't have to go into long orations. This is pretty telegraphic stuff. It gets across relatively easily what it is trying to say.

So I just submit to you and really hope that it can make some difference in your deliberations as a Subcommittee and in the full Committee itself and in the Congress that I think we haven't really—those of us who have been involved in this inside and outside the Government have, I think, not been as helpful to you as we should be in bringing this particular effort to your attention, because I think it can help you decipher—to organize detail and to figure out how to group things so we can understand a bit what we are doing, why we are doing it, and whether we are doing it. So that is the first point.

The second point I would like to just talk to you about just briefly is the issue of chemistry, really, if I can put it that way—I hope you won't mind—between the Congress and executive branch on this issue. It relates, of course, to the issue of volume, which Congressman Menendez was nice enough to bring up. I had just had a concern—while I played a role as chief economist in AID in the whole period—I was, for most of the time there the chief person in AID dealing with donor relations. I just became aware that one of the reasons why there was so much convergence around these targets was because the Europeans especially, and the Japanese also, because the Japanese went ahead of us for a year in terms of overall volume, were very concerned that we had a problem back home that we couldn't—that the Congress and the executive branch weren't together on what we were trying to do in the development assistance, development cooperation area. I just think we need to mend that fence. The reason I think we need to mend it is because we owe it to ourselves to be together about what we are doing rather than to be divided about it. We owe it to our partners.

I began to feel badly in relation to my colleagues in Europe and the Pacific because they were really concerned about—they wanted us to lead, and we weren't able to. We were falling behind because the volume was dropping. The reason was that we didn't have the kind of relationship of dialogue, discussion, and consensus between the Congress and the executive branch about development cooperation. I think in order for us to live up to the leadership which we owe ourselves, in order for us to live up to the leadership which others expect of us, we have really got to follow the Europeans, who really have managed to work out their executive/parliamentary relations in a way that is better than we have.

I cite here that we have lost in the last several years the chairmanship of the Development Assistance Committee for the first time in 50 years, the External Relations Vice Presidency in the World Bank being handled now very expertly by former Minister of Development Cooperation Mats Karlsson from Sweden, but we used to hold that position, and the UNDP in New York has also traditionally been American, now held by Mark Malloch Brown, a senior British person, who is also excellent. I don't have any problem with the best people serving in these positions. I have a problem with us losing the positions because of volume only. I think that we, therefore, owe it to ourselves to reconnect with the Congress and the executive branch in a different chemistry, in what I call positive circularity, picking up on a DAC report of 20 years ago, and really try to get our act together here in River City and see if we can't put ourselves back on the map in this field.

The final thing I would like to say is just to point out to you some figures, some little calculations that I did yesterday as I was working on this, which, stunned me. What I did was I just took the figure that you are considering here of $736 million for AID's programs for Latin America, and I said to myself I wonder how much that was back in the 1960's when we had the Alliance for Progress going and when it was a great priority in the Kennedy administration and there was considerable support in the Congress for what President Kennedy and, after him, President Johnson were trying to do.

As you may have figured out, as you deflate these numbers, $736 million in 1960's dollars becomes about $150 million, we are doing 30 percent today of what we were doing back in the 1960's. Then I began to think, I wonder how population growth and GDP growth have been in Latin America. I don't think the issue really is per capita aid to Latin America, in other words, how much does each Latin American get from our aid program. That is not the point. The point is, we are trying to leverage through these goals, we are trying to leverage major national societal, political, and economic change. We are trying to do it with financial resources. Yet Latin America is bigger in population today and Latin American GDP is very much bigger today than it was then because they have experienced substantial growth.

So if you take that into account, we are, in per capita terms and in share of GDP, our aid to Latin America has dropped to 15 percent today of what it was in the 1960's, and yet we have these ambitious goals that we are trying to achieve.

So I just think that we are going to have to worry about volume—if we are going to worry about aid effectiveness, as much as I would rather not bring it up, it almost seems impolite, but it seems to me that we have to confront the volume issue, and that we need to think about it in wholly different terms. I really wonder whether we couldn't—whether there hasn't been a sea change enough in the way the American people feel about these things to be able to think in terms of very different orders of magnitude and a different kind of leadership.

I have one other small suggestion for you at the very end of my paper, which may or may not be worthwhile, but I thought since your Subcommittee is focused just on Latin America, it might be helpful, since this process goes on at the global level, it just might be interesting to encourage a biannual meeting to correspond to the Western Hemisphere summits, which happen every 2 years in Latin America, to have the senior officials in the Inter-American Bank, the World Bank, the IMF, the UNDP and other agencies get together, have a paper written which reviews patterns and trends and policies over the last 2 years, put them in some context the way this publication does, but by region, and have a report which could be reviewed and discussed by them and some critics and analysts from Latin America. That discussion and regional report would then funnel into the summit process and which, as we do now with these kinds of reports, go to the G–7 summit every year, and to the ministers of development cooperation, so that you can tell what is going on specifically in the region and you can make some judgment using the organizing principle idea that Sylvia put forward, and that this could be useful to you here in Congress, could be useful in other parliaments around the world, and maybe we could change the whole dynamic here where foreign aid isn't such a bad world after all, that people really think this is important, we need to do it as a nation, the world expects it of us, we should expect it of ourselves, and we just need to do it.

[The prepared statement of Mr. Bradford appears in the appendix.]

Mr. BALLENGER. Thank you. I would like to say one thing that specifically seems to fit with the discussion, which is the fact that our Foreign Affairs Committee, which is basically the group of people here that are interested in whatever we do around the world, is broken up into five different areas, and I think those of us that are on the Western Hemisphere are finally interested in what is going on here. But when you end up with 10 people out of 435, somehow you don't build very big fires with those numbers.

In fact, as I remember, my wife and I have been involved in Central America at least for 35 years, and we found that you couldn't change the world, but you could pick a little piece of it and see what you can do with it. I am not sure that we weren't more effective before I got to Congress than I was after I got here. Somehow it appears that our Government gets in the way of being able to do it.

One of the ways that I think this—really I like about it, and I think it would be a very positive approach to be able to somehow measure—one of the reasons, the money—we look at—a lot of times we get in arguments here with throwing money at a problem, big government, we just throw money at it and forget whether we have accomplished anything. If there was a way to measure progress, which I think is what you are talking about here, we would have something to work with and say we are accomplishing this and so forth. You mentioned the effectiveness of aid, ways to increase the effectiveness of aid. Do you have in the back of your mind to measure it? I think difficulty we have with the American people is, first of all, we are very insular. If you lived in Europe, you would speak three languages and go to different countries all the time, and sometimes we don't even leave the State that we are in because we are very insular. You like it where it is. So, therefore, you don't develop the need or the purpose of what is going on in the rest of the world.

I think one of the biggest changes you can see about the effectiveness of doing something as far as the Western Hemisphere is concerned is the fact that I don't know of an area of this country—and I know where in live in North Carolina, we are having explosive growth of the Hispanic population—Mexican, Costa Rican Guatemalan and so forth—and all of a sudden you realize you have to—I have got a business, a manufacturing company, and in it we now have two Salvadorans and ten Mexicans and two Guatemalans and two Costa Ricans. All of a sudden these people in my plant are working with people that they didn't even know existed, probably. You ask them where is Guatemala, and before these people came, they wouldn't have the slightest idea where it was. If somehow in your mind you could work up a way of increasing the effectiveness of aid, I think I like the micro enterprises that I have seen working in El Salvador and in Nicaragua. Those are things that you actually are creating an atmosphere of a free enterprise system, which in my considered opinion develops democracy. At the same time, we might be able somewhere along the line to measure.

Your idea of maybe getting—I hate to have studies because usually it is a bunch of eggheads that don't go there very often that put a study together and they don't know what they are talking about when they are through. But you used the words "asset inequality."

Mr. BRADFORD. Yes.

Mr. BALLENGER. How would you approach that? How do you go about—it is a term we don't use. I just wonder what you mean by it.

Mr. BRADFORD. Yes, I was mulling over this problem that you had articulated yourselves about why is it we have had policy reforms in Latin America and a return to democracy and why the results have been so meager, especially on the poverty reduction and economic growth front. I think what happens is people think that the distribution of income in Latin America is bad. Why is the distribution of income bad? You are a businessman. You have probably figured it out before everybody else. The reason it is bad is because the distribution of assets is hugely skewed in Latin America in terms of capital, certainly financial capital, in terms of education. That is extremely important.

I think Latin America is moving quite nicely on this front, needs to move quicker, has further still to go. But it is impressive.

As Sylvia mentioned, the gender balance in education in Latin America is actually the women; there are more girls in school in Latin America than there are boys, which may or may not—maybe the problem now is to get the boys back in schools, but still——

Ms. SABORIO. I wouldn't worry about that.

Mr. BRADFORD. I wouldn't worry. I don't know. But the point is that the educational investment has got to be really a crucial thing. I think for a long time, to be very frank as an economist in saying that for a long time economists just didn't realize how—we spent too much time thinking about financial capital and not enough about human capital. We didn't think enough about investing in people. We always thought about investing in plant and equipment.

Then the final thing, which is probably the most sticky wicket of all in Latin America, is land. There just isn't a market for land in Latin America in the way that there is for other things, and the concentration of ownership of land really pushes out and excludes a lot of the rural population where a lot of the poverty is that I think Carl Leonard or Bill Schuerch mentioned in their testimony.

So I just think that—and what I really was trying to get at there is the—and I am not just trying to get at it for reasons of sustaining budget levels, but in a way I suppose that is the bottom line. This is a long process, and the fact that, we have reforms in the early 1990's and they don't pay off in the end of the 1990's, let's just hold on a little longer. The problems are deeper, and as Sylvia said, we need to go into second generation reforms, more social content. But the truth of it is these asset inequalities are much more difficult to deal with, take much longer than changing policies or changing income in a given year.

So I think that asset inequality really drives the politics, also. One of the reasons why you are not getting more socially responsive policies in Latin America is if you have got concentration of assets, you have got concentration of power, you don't have full democracies working, the majority doesn't have a voice, a real voice, can't really affect resource allocations in a fundamental way. So we have got a long way to go in democracy, too. Even though we may have elections, we don't have really strong representative systems where the poor can get their due. I think it is going to take decades, really, and I hate to say it, but it is going to take another 10, 20, or 30 years before—under circumstances where people are trying to rectify this to get this done.

Ms. SABORIO. I just wanted to add that development is a complex and an extremely long-term process. It requires patience, persistence, perseverance. But throughout all of this, you really need to have clear objectives so that over time you are building toward something. This is why a framework is absolutely necessary, so that at the end of the day you get results, however long it takes.

But I do think it is very troubling what we are seeing in some of these trends in Latin America, and it is the delinking of growth from poverty reduction. I don't want to be technical, but now it takes a lot more growth to produce the same amount of poverty reduction than was true in the 1970's and before.

I think it has partly to do with what you were saying in terms of asset allocation. But I think we really have to make a concerted effort to improve the primary distribution of income—that is, economic opportunity, how the production process actually happens—because I do not think that we have the political resolve in that region to do a lot of redistribution. So the best hope is to improve the primary distribution, to make room for small- and medium-sized enterprises to competitively participate in the production process.

Some of the Asian countries have developed very interesting supplier networks so that larger enterprises can pull along the smaller ones, which cannot really be expected to jump into a globalized, very competitive world on their own. But these things have to be fostered. We have to have that as a goal. If we do not pursue it, it is not going to happen on its own.

Mr. BALLENGER. In each of those situations—and I won't string this out a whole bunch, but one of the things that was so effective in the 1960's when we first started being involved in Central America was the International Executive Service Corps. I don't know whether we still have a very active group there or not, but that is how—I got involved through my wife's father, and not only did we send people down there, but in my own particular case, I brought several of the people that we were working with up to my place just to see how we ran a manufacturing company in the United States. They went back—and I am not saying we did a good job, but I still think El Salvador probably has done a good development of nice light economy, light industry, with jobs for most people. I don't know how the poverty level stacked up there, but that is the country I spent most of my time in until Mitch came along and then that aimed us in a different area.

But one of the things—and you recognize this—every time I see one of the Presidents back home, they are talking about you all are about to redraw your INS laws, your immigration laws up there, and in El Salvador and Mexico and places that will speak very strongly to you, say, please don't send those people back. I think just about every country down there, their second largest cash-flow of money comes from the people that are working in this country sending it back. That is an aid that you can't really measure, but you don't know how effective it is. If the people are still living in a poor little place and they are not going to create new jobs, they just have money to keep them at the same level of humanity, if you want to call it, have you accomplished a great deal? Except there is substantial funds flowing in that direction.

Mr. BRADFORD. Right. Sylvia mentioned the fact that there is—the informalization of the labor market, I think was what you said, is not actually a good thing. It is better than—if there is no room in the formal market, it is better to have an informal economy than none at all. But I think what she was pointing to was the fact that we really need to be aware that there is a limit to that, and we need—it is interesting that we didn't consult at all in our testimonies, but we both used this term, "pro-growth" and "pro-poor" economic policies, which I think really does mean shifting the emphasis not just—I was a little bit concerned about the discussion earlier, and I am not necessarily against it, but about focusing attention on the composition of lending by the international institutions and shifting more toward social programs.

That will help. Pressure on the governments to shift their budgets toward social programs and away from defense would help probably more. Altering economic policy so that economic policy is more pro-growth and pro-poor, for example, having a more progressive tax system, things like there, where, in other words, it isn't just a question of taking the social agenda and saying, we have an economic agenda which is represented now by the Washington Consensus, which you probably heard about, but it is really about going back into the orthodox Washington Consensus macro policies and putting social content in them so that, the macro policy of the country that matters really is moving the country in a direction of greater employment in the formal sector, more incomes and less reliance on foreign aid and less reliance on remittances from immigrants here back to Central America.

Mr. BALLENGER. I don't want to keep you all here forever, and this conversation with three is probably not what either I planned or you planned.

Mr. BALLENGER. But I would like to say that I think it has been a very constructive hour that we have spent here, and the reality is I like this. I think I probably ought to look at it really seriously and be frank with you. My interests will continue to be in Central America and South America, and anything that I can do here, if you come up with some fabulous idea that we can assist with, I go to Central and South America, on your tax money, excuse me, about four or five times a year trying to figure out better ways to do things. In reality, you need somebody that has practically approached and knows the problem there to be able to do anything about it.

What I do with the problem, somebody calls me up on the telephone after Mitch and says—this is a funny story, quickly, and I will shut up. It is a friend that we had worked with in Guatemala who helped us build hospitals there. They had gone over—he was with an NGO in Honduras, and he calls up and says, the clothes, the drugs, that is really nice, but we really need something a little bit more permanent than that, what can you do? I said, I don't know, what do you want me to do? He said, how about corrugated galvanized steel for roofing for the houses? They all got wiped out. I said, I don't know, I will check. My son-in-law is in construction. He said, sure, I can get you some.

So I called him back, and I said, yes, we can get you some, how much would you like? He said, How about a hundred tons?

Now, that kind of blew my mind.

Mr. BALLENGER. But when you get Rotary International and you have a steel gathering here, and just because of the location, we had U.S. Steel and AK Steel, Bethlehem Steel and another steel company, and each of them pledges 20 tons, so we got 100 tons. I think somewhere along the line it was about 2,000 houses that we helped build.

Then our friends in Nicaragua said, Mitch hit us, too, what are you doing?

Mr. BALLENGER. So we had to do the same thing for them.

When you see Habitat for Humanity—I don't know anyplace in the world that doesn't see a Christian ethic at work when we are all trying our best to give people a home. I don't know how you all feel about that, but that to my way of thinking is the ultimate in democracy. If everybody had a house worth living in, we would have a good base to begin with.

I will shut up. I would say thank you for this, and I greatly appreciate your participation in the program.

Ms. SABORIO. Thank you.

Mr. BRADFORD. Thank you.

Mr. BALLENGER. With that, the hearing is adjourned.

[Whereupon, at 4:05 p.m., the Subcommittee was adjourned.]

A P P E N D I X

JUNE 28, 2000

Opening statement of Chairman Elton Gallegly

Two weeks ago, at a hearing of this Subcommittee, the Principal Deputy Assistant Secretary of State for Western Hemisphere Affairs stated that, and I quote, "perhaps the most important challenge to democracy in the Hemisphere is poverty"... "until democratic leaders can show progress in attacking poverty, democracy in the hemisphere will not be complete, and will not be secure".

The Secretary then pointed to public opinion polls in Latin America which consistently reveal that while the broad populations endorse democracy as a concept, they are less than satisfied with the performance of democracy especially in such critical areas as public services, standards of living and poverty alleviation. Perceptions of economic insecurity run high and the failure of Latin leaders to address these issues, according to the Secretary, has led to a new generation of demagogues, populists and those who yearn for the old days of state authority and whose democratic credentials are suspect.

In a recent study conducted by the United Nations Economic Commission for Latin America it was reported that 15 percent of the regions's people live in extreme poverty, a level which has hardly changed in 20 years. And, a recent report of the IDB stated that some 200 million people in the region live on $2 a day or less and that the gap between the rich and poor has widened in the 1990s.

In a February speech, World Bank President James Wolfenson stated that despite the recent economic gains of the region, poverty actually increased by some 14 million more people. In his speech he went on to say that "the prospects for future reduction in the number of those living in poverty do not look bright" and that "even under a brighter alternative scenario of smoother and more rapid growth, neither Latin America or the Caribbean would see much improvement in the numbers of those living in deep poverty".

These facts and predictions are disconcerting especially when we know that on average over the past several years, the amount of funding for Latin America from institutions such as the World Bank, the IDB, the International Finance Corporation and even A.I.D. is estimated to exceed some $14 billion annually.

So one must ask questions such as:

* Is there something wrong with current assistance programs?
* Which kinds of assistance programs can be the most effective?
* Are the assistance programs effectively targeted to the nations and programs most in need?
* What are our aid Agencies and multilateral institutions doing to reshape their priorities and programs to make them more effective with respect to programs promoting growth, development and poverty reduction?

Our hearing today is an attempt to better understand these bilateral and multilateral aid programs for Latin America, to determine what is working and what isn't and how to achieve better results with the assistance being made available?

Statement
Hon. Robert Menendez
House International Relations Committee
Subcommittee on the Western Hemisphere

"Development, Growth, and Poverty Reduction in Latin America: Assessing the effectiveness of assistance"

June 28, 2000

Thank you, Secretary Schuerch, and Administrator Leonard, for agreeing to come speak with us today about this critical topic, "Development, Growth, and Poverty Reduction in Latin America and the Caribbean." The subtopic, "Assessing the effectiveness of assistance," is equally important and I look forward to taking the time today to reflect on this question. But I also hope we will talk about the levels of assistance, and about whether or not we are short-changing the region – and, therefore, our own security and well-being -- with our declining aid levels. I know I will be preaching to the choir here today, of course, on the need to increase assistance to Latin America. I think our challenge is to figure out together how we can build a bigger constituency for Latin America and the Caribbean. Sometimes it amazes me that there is not a bigger constituency for the region that is the only area to border our United States – but it is a fact.

- Whether our concern is drug production in Colombia, or immigration from Mexico, or most of the other development issues in the region, what we really should be talking about is poverty reduction.

- If we want to talk seriously about long-term, sustainable development, we must talk about the types of investments that are critical to reducing poverty. These are: education, first and foremost; health care; property rights; judicial reform; and good governance.

- U.S. foreign assistance for the region is our primary tool for addressing development issues. Yet, aid to Latin America has been drastically cut. In a 12-year period, the U.S. reduced its bilateral assistance to the region by two-thirds, from $1.8 billion in 1985, to $600 million in 1997.

- In 1988, Latin America represented 17% of total USAID programs yet ~~only one~~ 10 years later, in 1999, it represented only 7%. In the FY' 00 budget, and in the FY '01 budget request, the level has remained at or near this low level.

- Let's put this in perspective: Latin America and the Caribbean contains more than 1 in 6 of the world's nations, yet gets only 7% of our aid; the region accounts for 12.5% of the world's population (750 million of six billion), yet only 7% of aid. Of those living in poverty in the world, nearly 30% percent of them live in Latin America and the Caribbean, yet, again, only 7% of our aid – the overall purpose of which is to reduce poverty – goes to the region. Most important of all, the region borders our country. Most of the drugs and most of the immigrants coming into our country originate from south of our border.

- While electoral democracy in Latin America has advanced in the past 20 years, reductions in poverty and corruption have not. Two decades ago, more than half of the countries in the region were under authoritarian rule – including all but four of the non-English speaking

Caribbean. Today, only one country has not had even one democratic election. At the same time, however, poverty has remained constant – even gotten slightly worse. Early this year, more than 36% of households in Latin America were living in poverty – in 1980 the figure was 35%.

- We all know that Latin America is a place of 21st century opportunities and 19th century problems. Multi-million dollar company headquarters exist alongside third world shanty towns and new Mercedes Benz' cruise past the more than thirty-five percent of the population that lives below the poverty line. Wealth and income gaps in the region, already the highest in the world in the 1970's, widened dramatically in the 1980s – the "lost decade" of no growth and high inflation – and have continued to increase even with the resumption of growth in the 1990s.

- In Latin America, the ratio of income of the top 20 percent of earners to the bottom is about 16-1 (almost 25-1 in Brazil) – which compares to about 10-1 in the U.S., and about 5-1 in Europe.

- In countries such as Bolivia, Ecuador, Honduras, and Nicaragua, more than 50% of the population lives in poverty. Clearly, this is not sustainable.

- In 1950, just 1.5 percent of farm owners in Latin America accounted for 65 percent of all agricultural land. Unequal land distribution, then the highest in the world, has actually risen since.

- Narrowing the gap between these parallel realities is a prerequisite for long-term political and social stability in the region. U.S. policy towards Latin America in this new century should seek to address these inequities by increasing our support for social, education and health care programs, while at the same time expanding our trade and economic ties.

- Investment in education is probably the most important. People usually cite jobs as the most effective way to combat poverty. But, statistics demonstrate that they must be good jobs – jobs that require skills obtained through education. A recent UN study shows that having a formal job in the public sector or in a company is no guarantee that the worker and his or her family are living above the poverty line: In 9 of 16 countries analyzed, 30% to 60% of private sector wage earners live in poor households! Trade is not a guarantee of a good job – education is the best guarantee.

- In East Asia after World War II, poor families saved their money and invested it in education for their children – and we've seen the results in those "tiger" economies. In Latin America, the country with the greatest poverty reduction over the past few years, Costa Rica (from 32% of the population in 1991 to a relatively low 20% in 1998) is also the country that invested the most in long-term education.

- The multi-lateral development banks have sought in recent years to increase lending for social needs (education, health, clean water, environment). However, only 18% of the IDB's total lending last year went for social needs, a decrease from the 24% lent in 1998 for these purposes. At the same time, total World Bank lending for social programs fell to $1.4 Billion (only 19% of the total) from $2.6 Billion (44% of the total) the previous year.

- The challenge we face is to demonstrate to the American public and other Members of Congress the nexus between poverty in Latin America and illegal immigrant and narcotics flows into the United States – and to change our polices to address poverty, not drugs and immigrants. Latin Americans understand this, and criticize our efforts as ineffective. In a recent compilation of foreign media reaction, the State Department wrote: "Most [Latin American] analysts judged that U.S. attempts to stem the flow of illegal immigration and drugs had done little to remedy the underlying economic inequalities which fuel the situation."

- So long as the economic outlook to our South remains depressed and hope evasive, we will not see a decline in illegal immigration. Nor can we expect a decline in the narcotics trade when the reality for many poor farmers is that growing coca offers the best chance to feed their families.

- There does seem to be some correlation between economic progress and democratic progress. Certainly Argentina, Chile and Uruguay have recently consolidated their relatively strong democracies with elections that are beginning to be called --as was the case recently in Argentina -- "boring." This is good news, and it corresponds to the southern cone region's relative prosperity. In these three countries, fewer than 20% of households live in poverty. This compares favorably to the rest of the region, where an average of more than 40% of the population is poor.

- Corruption remains a problem that adversely affects economic and political institutions and must be rooted out. Venezuela, with its oil, and Colombia, with its abundant natural resources, should be relatively wealthy and should have built up a middle class over the years. Corruption, along with a lack of investment in their countries' human resources, has prevented real progress in combating poverty.

I have proposed a Development Fund for Latin America and the Caribbean, and I will soon introduce a bill that would authorize the fund. In the period 1985 to 1990, U.S. non-military, non-narcotics assistance to the region averaged more than 1.5 billion per year. In the period 1995-2000, the average yearly assistance was only $600 million. Latin America is too important to our own national well-being to allow this hemorrhaging of assistance to continue. Don't get me wrong, there are numerous other regions of top importance too – the Middle East; Russia, Ukraine, Armenia and the other states of the former Soviet Union; humanitarian and peace-keeping needs in Africa; are among the most prominent. But nearly every time an emergency comes up, when funding is needed elsewhere, Latin America funds get redirected to meet the need. We're robbing Peter to pay Paul. And it will come back to haunt us.

My proposal would set a floor – not a ceiling – for development assistance to Latin America and the Caribbean. Further, it would gear assistance more towards the social, economic and democratic development programs that have the best chance of reducing poverty and creating equal partners among our closest neighbors.

I look forward to hearing from each of you today, as well as our distinguished guests on the private panel, about what you perceive to be the best ways forward.

Thank you.

Statement of
Carl Leonard
Acting Assistant Administrator
Bureau for Latin America and the Caribbean
U.S. Agency for International Development
House International Relations Committee
Subcommittee for Western Hemisphere
June 28, 2000

Introduction:

Mr. Chairman and Members of the Subcommittee, I want to thank you for the opportunity to testify before you today. This subcommittee has taken a strong interest in probing the major trends that affect the region -- not only the headlines, but the more subtle developments taking place behind those headlines. At your request, I will direct my remarks to how foreign assistance programs managed by USAID are promoting the economic and social development of Latin America and the Caribbean and in particular, how these programs are alleviating poverty.

The work that we do everyday takes place largely outside the headlines, but we strongly believe that our goals -- drawn from the hemisphere-wide agreement of the historic 1994 Summit of the Americas -- will help achieve greater prosperity throughout the region while advancing U.S. interests. In implementing the work program of the Summit of the Americas, we have developed a very close, collaborative relationship with the IDB. In areas such as microfinance and basic education, USAID has provided initial funding for pilot efforts, technical assistance, training, and institutional development. The IDB has provided larger volumes of loan resources to permit broader dissemination of successful results, in areas appropriate for public sector funding.

As Ambassador Lino Gutierrez, Principal Deputy Assistant Secretary for Western Hemisphere Affairs, testified before this Committee earlier this month, "while democracy is more widespread than ever, recent events remind us that democratic progress in the Americas is neither immutable nor uniform." Recent crises in Peru, Paraguay, Ecuador and Haiti underscore the fact that democracy is not very deep-rooted in these countries. Ambassador Gutierrez also noted that poverty is perhaps the most important challenge to democracy in the Hemisphere, and that Latin America has the most unequal distribution of income of any region in the world.

Acknowledging these challenges, however, does not signify pessimism with regard to the future of democracy in the Americas. Latin America is making progress and our U.S. foreign assistance programs are achieving significant results and thereby contributing to U.S. national interests in the region.

Recovery from the "Lost Decade of the Eighties"

In contrast to the "lost decade of the eighties", in which GDP per capita declined by 9 percent, the economic reforms introduced in the early 1990s have brought about a resumption of growth and a decline in poverty in most of the Latin America region. In the 1990s, according to the World Bank, GDP per capita grew at about 1.1 percent per year. This growth has been accompanied by improved purchasing power in the region. U.S. exports to the region expanded 163 percent between 1990 and 1998, creating more than 2 million jobs in the U.S. Latin America and the Caribbean (LAC) is our fastest growing export market. In Central America alone, imports from the U.S. have nearly doubled over the last five years to almost $10 billion. This improvement in LAC's economic fortunes followed a sustained reform effort by many countries in the region aimed at enhancing the role of market forces and increasing the region's real and financial integration into the global economy. The worsening income distribution witnessed during the 1980s has been arrested and poverty rates have declined in most of the region since 1990. The proportion of Latin American households living in poverty has decreased from 41 percent in 1990 to 36 percent today.

Reforms and Growth in the 1990s

It is important to note that the largest poverty reductions in the 1990s have occurred in the countries that adopted the reforms first, most notably Chile, which almost halved the proportion of households in poverty between 1987 and 1996. Other aggressively reforming countries also achieved major reductions in poverty. These include Peru (57.4 % of the population in 1991 to 50.7 percent in 1997); El Salvador (from 59.7 percent of the population in 1991-92 to 48 percent in 1998), and Costa Rica (from 31.9 percent of the population in 1991 to 19.7 percent in 1998). Other countries, such as Honduras, have made relatively little progress while still others, chiefly non-reforming countries, have seen the proportion of households in poverty actually increase.

Good Governance and Poverty

Until democratic leaders can show sustained major declines in poverty, democracy in the Hemisphere will not be complete - and will not be secure. A recent survey identified a strong correlation between income concentration and support for democracy. In countries with the most equitable income distributions in Latin America, more than 80 percent of the population believe that democracy is the best form of government, while less than 50 percent of the population support democracy in those countries with the worst income distributions.

The region's democracies are finding that economic growth and the macroeconomic reforms that helped generate that growth, while essential, are not sufficient. Recent trends in employment generation and wages suggest that the current pattern of growth has been accompanied by high unemployment rates, a widening wage gap between skilled and unskilled labor, and, in some countries, an actual decline in the real wages of the unskilled. At the Second Summit of the Americas in Santiago, the Hemisphere's democratically elected heads of state underscored the need to remove the barriers that deny the poor access to economic opportunity. The Plan of Action they adopted proposes increased access to credit, other financial services, secure title and property, and infrastructure.

Through the Summit of the Americas' process over the past six years, hemispheric leaders have also increasingly recognized that good governance and positive social outcomes are mutually reinforcing. In fact, a recent World Bank report has found that improvements in the rule of law correlate highly with economic growth and poverty reduction.

A growing body of literature tells a consistent story about governance. Good governance creates a predictable environment for firms and households to invest and increase their productivity, and these investments support both increases in income and improvements in social indicators such as literacy and mortality. We now have a better understanding about the importance of the relationship between poverty and good governance. Indeed, the same countries that are succeeding today, having successfully implemented the "First Generation" of macro-economic reforms, are the ones giving priority to the rule of law, citizen participation and anti-corruption, carrying out "Second Generation" reforms. Other countries have not addressed either basic economic reforms or governance and are caught in a vicious circle of poverty and corruption.

The USAID Response

Let me now describe how USAID is promoting economic and social development and is supporting poverty reduction and improved governance in the region. Our core program in Latin America and the Caribbean, focuses on the poorer countries of the region. It is based on achieving the objectives established in the Summit of the Americas, including strengthening democratic institutions, fostering open markets and enhanced trade, and reducing poverty in the hemisphere.

USAID works collaboratively with other USG agencies, the World Bank and the Inter-American Development Bank, our bilateral partners, and NGOs to assist both governments of the region and their citizens to achieve higher rates of growth on a sustainable basis, accelerate integration into the global economy through enhanced competitiveness, improve governance and the administration of justice, strengthen education and health care, and address environmental degradation and disaster mitigation.

USAID contributes to increasing the income of the one-third of households living below the poverty line through targeted activities that increase their productivity. These activities do three things:

First, they increase **access and reduce barriers** to services that the poor need to achieve their full potential. These include: financial services (micro finance), education and health care, land title and property rights, and justice and government.

Second, they seek to improve **governance, accountability and the enabling environment** within which the poor work to assure that they have access to a level legal and regulatory playing field, participate fully in the selection of governments and have effective national and local government institutions.

Third, they assist countries in crisis **prevention and mitigation.**

Improving Access and Removing Barriers

Reducing barriers to market access by the poor is an important ingredient of poverty alleviation throughout the region. Institutional barriers are particularly pronounced in property and financial markets, to which access by the poor has been historically limited. Therefore, USAID has introduced innovations to help address problems of market access.

USAID also combats poverty through improved access to credit, particularly micro-finance. We have learned that, despite the precarious situation of the poor, the chief obstacle to credit access is not risk but the cost to the lender of administering small loans and accounts. In addition, the poor typically have few assets that can easily serve as collateral and traditional financial institutions often find it difficult to appraise the creditworthiness of poor borrowers. USAID has long been a leader in funding innovative techniques and instruments to give the poor access to small loans on terms that they can afford and that also cover the full administrative and capital costs of the lending operation.

In countries where we have focussed on credit, a significant part of the potential market of poor entrepreneurs now has access to credit. In Honduras and in Bolivia, an estimated 31 and 23 percent respectively of borrowers have access. The challenge for USAID is to continue to expand this access and to assist microfinance institutions to achieve full financial sustainability.

Since the 1980's, we have seen much progress toward adoption of policy frameworks governing property rights and access, which operate on market principles. Yet, still today in several LAC countries, only half of all property is formally registered. The lack of formalization of property rights is a key impediment to economic growth. Formalizing title to property is essential to creating a basis for commerce, services and governance. Through formal documentation of property, governments recognize basic liberties in uses and transactions and at the same time establish an information base vital to public and private planning, revenue collection, and service provision. More broadly, the same institutional reforms and information base that empower the poor to participate in markets are also critically needed for expanded international investment in the region and a vibrant global marketplace. This, in turn, will generate jobs and economic opportunity.

On behalf of the U.S., USAID has assumed responsibility for leadership of the Summit initiative for modernizing property registry. We are working with the multilateral development banks and other partners to increase transparency, decrease transaction costs, expand access, and improve the security of tenure.

Education

The single most powerful tool for reducing poverty and improving equity in the long run is high quality primary and secondary education. Besides boosting earnings of the poor, it has been shown to have a catalytic role for those most likely to be disadvantaged: women, indigenous groups, and the rural poor.

Sustained by USAID assistance, primary school enrollments, in most countries of the region, exceed 90 percent. Girls' school enrollment rates are equal to or greater than those of boys in most countries, except in Haiti, Guatemala, and Bolivia.

Nevertheless, two serious problems remain. First, although access to schools is almost universal, the quality of those schools, in many areas, is deficient. Many schools which serve the poor lack textbooks and other basic instructional materials. Rural schoolteachers are often poorly trained, and curricula are often antiquated and of little relevance to the poor rural population. As a result, repetition and drop out rates are unacceptably high. In many Latin American countries, more than one-third of all students fail to reach the fifth grade. In addition, the lack of access to secondary schools for the most talented students, especially in rural areas, is a major obstacle to their escape from poverty. USAID's response focuses on management, curriculum, new Internet tecnologies, and policy reform. Specifically our programs promote decentralization and local control and accountability, increased availability of textbooks and other instructional materials, improved teacher training, and better testing and evaluation systems.

Health and Population

Latin America has made notable progress in health in the last decade. Declines in total fertility rates, particularly in USAID-assisted countries, have improved the health status of mothers and their children. Decreased family size increases the probability that children will remain in school and will have accessed to needed health care. In the last ten years, mortality rates for infants and children under five significantly declined in the region, even in the poorest countries. USAID has helped countries improve water and sanitation, widen access to health services, and raise rates of coverage with vaccines that prevent life threatening conditions such as whooping cough, measles, polio, and tetanus. With USAID support through the Pan American Health Organization (PAHO), polio has been successfully eradicated in the Americas, the first region in the developing world to do so. USAID continues to support PAHO's work to eradicate measles in this hemisphere.

Despite these successes in Latin America, health problems associated with poverty remain. Maternal mortality ratios in some countries are still more than ten times the rate of developed countries. Although national indicators demonstrate greatly improved health conditions in Latin America where USAID works, these averages mask great differences between rural and urban populations, between elite and ethnic populations, and between those who are educated and those who are not. Among indigenous populations in Peru, Guatemala and Ecuador, the rates of child survival and basic access to services are much lower than the national average. Meeting the needs of these underserved and marginalized populations is a priority of USAID programs in the region.

Although HIV is still in an early phase in most of Latin America, the Caribbean region is the most severely affected with some of the highest prevalence rates outside Sub-Saharan Africa. USAID is working to reduce cross-border HIV/AIDS transmission and is placing renewed attention on countries in the Caribbean that are threatened by the HIV/AIDS epidemic.

Access to Justice and Responsive Government

Our programs also focus on increasing citizens' access to justice and good government. Through public education programs and the strengthening of governmental and NGO capacity, citizens, particularly women, children, and disadvantaged groups, are gaining access to needed services. Programs focusing on access to justice have had a profound impact on women and indigenous people. For example, in Ecuador the Ministry of Social Work and the Ministry of Justice have collaborated on an innovative program to provide specialists in neighborhood police stations to assist women who are victims of domestic abuse. Over 30,000 poor women availed themselves of this service last year. Missions are also increasing their support of successful models of "Justice Houses" which provide one-stop neighborhood assistance for the poor. The programs meet a wide variety of needs from domestic and child abuse to resolution of property disputes. What they all have in common is providing, often for the first time, access to a fundamental right that all governments must ensure.

Improved Governance, Accountability and the Enabling Environment

Investments in the region have paid off significantly over the past ten years with the successful institutionalization of democratic processes, the end of conflict in Central America, reductions in human rights violations, and peaceful transitions of power.

Over the past decade, USAID has expanded its support for rule of law. We have supported major Constitutional reforms to improve justice systems, to provide access to justice for the poor and disadvantaged, and to protect basic human rights. High levels of crime and violence affect all and threaten to undermine people's belief in democracy. Therefore, USAID works with national and local governments and other U.S. government agencies to develop the capacity to provide basic security and justice.

USAID is a leader in treating corruption as a significant development issue. USAID missions support anti-corruption initiatives through justice, civil society, or other public sector support programs. These include: automated financial management systems to increase transparency; civil society groups that monitor elections, procurement, and selection of judges; and technical assistance to controller general offices to improve their ability to audit the use of public funds and to investigate cases of fraud. USAID has encouraged the participation of other donors in this important area and led the formation of a donors' forum that focuses on improving transparency and attacking corruption throughout the hemisphere.

The emergence of elected, local governments is an important trend in the consolidation of democracy in the region. Our support to local governments is strengthening opportunities for citizen participation and decision-making and the provision of improved services needed by local citizens. Elected officials run municipal governments in 23 countries, up from only six two decades ago. In twelve countries, with USAID support, small and medium size municipalities are strengthening their ability to respond to citizen needs. By bringing the responsibilities of governance closer to the people most concerned, we are helping to reinforce the foundations of democracy.

Crisis Prevention and Mitigation

The poor are especially vulnerable to economic downturns and natural disasters. Latin America is particularly vulnerable to natural disasters and these have an impact similar to those of economic crises. Hurricanes Mitch and Georges have had severe impacts on the poor in some of the poorest countries in Central America and the Caribbean. The poor are more likely to have to remove children from schooling, to postpone needed medical treatment, and even to sell productive assets, merely to survive. As a consequence, they are less able to participate in the subsequent recovery. This underlies the importance of sound economic management, effective regulation of financial systems, and prompt, effective and well-targeted safety net programs.

A particularly important aspect of prevention is sound environmental management. The impact of Hurricane Mitch on the poorest people in the two poorest countries in Central America demonstrates the relevance of improved environmental management to the welfare of the poor. Approximately one dollar invested in improved watershed management can save several dollars of post-disaster reconstruction costs when the inevitable storms and floodwaters strike.

Another aspect of prevention is microfinance. A recent study by USAID demonstrates that a very important benefit of microfinance is that it enables the poor to build an asset base to carry them through difficult times, to borrow additional sums to carry them through both personal and systemic crises, and to diversify their sources of income.

One of the most striking facts of the experience of the 1980s and early 1990s was the degree to which the poor suffered more in the decline than they benefited from the subsequent recovery. We in USAID are working very closely with other donors through the Stockholm Consultative Group and other processes to assist countries to prevent crises and to improve the resilience of the poor to cope with the crises that do occur.

Deforestation, unsound land use, and inappropriate agricultural practices significantly increase the vulnerability of LAC economies and the poor to the impacts of natural disasters such as hurricanes, floods and fires. USAID's environmental programs, including parks protection, forest management, small farmer hillside agriculture, and watershed restoration, are helping countries reduce their vulnerability to natural disasters. For example, in Mexico, Central America and Brazil, USAID, collaborating with other U.S. government agencies, NGOs and national governments, provides education programs that promote alternatives to slash-and-burn agriculture and unsustainable logging practices. The establishment and protection of the Meso-American Biological Corridor conserves globally important biodiversity and is key to a viable tourism sector. In Central America, Haiti and the Dominican Republic, USAID is assisting in watershed management as these countries recover from Hurricanes Mitch and Georges and reduce their vulnerability to future disasters.

Importance of the Prosperity of the Overall Economy

While our targeted poverty interventions are key to the success of our overall efforts, we cannot overlook the critical importance of economic growth. Achieving that growth will require continued macroeconomic stability and effective implementation of a broad range of policy and institutional reforms aimed at improving the enabling environment for both foreign and domestic productive investment.

Examples

From 1988 until 1997, I served as USAID Mission Director in three countries, Costa Rica, Bolivia and El Salvador. Each of these countries established coherent and growth oriented polices, made a strong political commitment to change, and took advantage of USAID's targeted programs. While no one would claim that foreign assistance is the determinant factor in their success, our programs in each country worked with governments and citizens alike to achieve significant results. In **Costa Rica** the stabilization and subsequent restructuring of the economy built on long term investments in education and health brought the country's per capita gross domestic product to around $5,800 - 70 percent higher than the world average. Today Costa Ricans are well educated, healthy, with a life expectancy equal to that of the United States.

Bolivia experienced a dramatic recovery from the economic chaos and hyperinflation of the mid-1980s. USAID has played an important role in helping Bolivia to build institutions, strengthen popular participation, discourage illicit crop production, and create alternative development opportunities.

For **El Salvador**, the 1990s saw the signing of the Peace Accords, and policy reforms that ended the conflict, achieved national reconciliation, spurred strong economic growth, reduced poverty and strengthened democratic institutions.

FY 2001 Program: USAID's FY 2001 resource request for the LAC region totals $ $646 million. Of this amount, $264 million is Development Assistance (DA), $86 million is Child Survival, $133. 5 million is Economic Support Funds (ESF), $55.5 million is International Narcotics Control (INC) for alternative development (out of a total of $219.3 million for all INC funding), and $106.9 million is PL 480 Title II.

The USAID FY 2001 program for LAC addresses the highest priority goals for the region:

- Promoting broad-based growth in developing and transitional economies;
- Increasing adherence to democratic practices and respect for human rights;
- Stemming the flow of illegal narcotics into the United States;
- Preventing or minimizing the human costs of conflict and natural disasters;
- Protecting human health and reducing the spread of infectious diseases; and
- Securing a sustainable environment in order to protect the United States and its citizens from the effects of international environmental degradation.

Special Priorities for USAID:

Support for "Plan Colombia" and Reducing Regional Drug Trafficking

The United States has a compelling national interest in reducing the flow of cocaine and heroin to our shores, and in promoting peace, democracy, and economic growth in Colombia. As in Peru and

Bolivia, success in battling drugs requires a concerted array of programs, including improved governance, economic development, and justice reform. The Clinton Administration has proposed a multi-year integrated U.S. response to "Plan Colombia." The proposal includes $127 million in FY 2000 and $90 million in FY 2001 for USAID managed programs. These programs would address three high-profile areas of U.S. policy in Colombia: reduction of illicit crop production through alternative development, programs for internally displaced persons (IDPs), and increased democracy through citizen participation and rule of law.

Concluding the Hurricane Reconstruction Programs in Central America and the Caribbean

The two hurricanes—Mitch and Georges--that devastated the Caribbean and Central America in late 1998 were a serious setback to the people and to the economies of the region. The two most devastated countries, Nicaragua and Honduras, are the poorest countries in Central America. In a week's time, decades of developmental progress were lost as roads, bridges, schools, health clinics, crops, and livestock were destroyed. In Central America, the U.S. Army Corps of Engineers estimated the damage at $8.5 billion.

On May 21, 1999, Congress approved the Administration's request for $956 million in supplemental FY 1999 funds for the Central American countries affected by Hurricane Mitch and the Caribbean countries hit by Hurricane Georges. It included $280 million to repay accounts that were used to fund the emergency relief effort and $621 million for reconstruction. Principal foci of the reconstruction assistance are the restoration of national health care delivery systems, community water and sanitation, and economic reactivation through rebuilding farm-to-market roads, and re-establishment of agricultural production. The replacement of lost housing and shelter, rehabilitation and re-supply of damaged schools, disaster mitigation, watershed restoration, and support for local governments are also critical priorities that USAID is addressing.

Immediately following the Hurricanes, our Missions put all available resources to work, including funds from our Office of Foreign Disaster Assistance (OFDA), food aid, and funds reprogrammed from ongoing activities to respond to humanitarian and emergency needs. With the passage of the supplemental appropriation, we've worked hard to design sound reconstruction programs in all countries and USAID missions have obligated 98% of the supplemental funds they manage.

As we continue to expedite implementation of the hurricane reconstruction programs, USAID is doing everything possible to ensure an extra layer of accountability. We have included concurrent auditing and hired independent accounting firms to assist the work of host country Controllers General, who play a role similar to our General Accounting Office.

We will continue to work with other donors to create additional monitoring mechanisms that will review procurements, audit financial records and inspect work completed under the reconstruction program. We believe that all these steps are necessary to give the American taxpayer, as well as the citizens of these countries, greater confidence that these funds are being spent wisely.

We continue to view this undertaking as one of our highest priorities and we will achieve the relief and reconstruction results promised to Congress by the end of December 2001.

Conclusion

In conclusion, for democracy to flourish in the region, we need to sustain efforts to expand access, improve governance, and confront crises. Because of our close geographic, economic and cultural ties, development and democracy in Latin America and the Caribbean matter greatly to the United States. USAID's field presence and programs are an integral part of US foreign policy.

The nations of the Hemisphere have set ambitious goals of greater prosperity, reduced poverty, and strengthened democracy. That will require an acceleration of growth and reduction in inequality. With sustained commitment, we know steady progress can be achieved. We look forward to working closely with the Subcommittee and Congress in the achievement of these shared goals.

DEPUTY ASSISTANT SECRETARY WILLIAM SCHUERCH TESTIMONY BEFORE THE SUBCOMMITTEE ON THE WESTERN HEMSIPHERE HOUSE COMMITTEE ON INTERNATIONAL RELATIONS

Introduction

Chairman Gallegly, Ranking Member Ackerman, and other Members of the Committee, I appreciate the opportunity to meet with you today to discuss the important role that the World Bank and the Inter-American Development Bank (IDB) play in promoting economic growth and poverty reduction in Latin America and the Caribbean. While most Latin American countries rely far more heavily on private financing and the multilateral institutions now provide only a small fraction of total resources flows, these institutions are central to the region's efforts to address its economic and development challenges. They promote growth, stability, open markets, and democratic institutions while advancing fundamental U.S. values throughout the region. At the same time, U.S. support for the World Bank and IDB operations in Latin America entails only modest budgetary costs.

Unprecedented globalization, supported by advances in technology and communications, has opened new opportunities for the world economy. Major political and economic changes are accelerating in many areas of the world. This is an era of great challenges. In our integrating world, the United States has a growing stake in the economic and political stability and success of other countries –we are now more likely to benefit from their success, and more likely to be damaged by their failures. And as you well know, Latin America is particularly important in this regard to the United States given our strong cultural, economic, and strategic interests in the region. For example, Latin America accounts for twenty percent of both U.S. exports and U.S. foreign direct investment.

The World Bank and the IDB are among the most effective and cost-efficient means we have to help the countries of Latin America and the Caribbean address their long-term economic and development challenges. Ultimately, it is a country's own commitment to sound policies that is the most critical factor in its ability to improve the economic welfare of its people. But when such a commitment is genuine and policies are sound, the World Bank and the IDB -- as well as USAID and other bilateral donors -- can provide valuable supporting roles in promoting sustainable economic growth, open markets, poverty reduction, environmental protection, and good governance.

I would like to discuss two broad areas today: (1) the current economic and social situation in Latin America, including the key development challenges the region faces, and, (2) the roles played by the World Bank and the IDB, as well as our development agenda for increasing the effectiveness of these institutions.

Economic and Social Situation

Latin America and the Caribbean have made important strides in implementing sound macro-economic policies, adopting more outward-oriented and private sector friendly environments, and improving public sector management. Despite individual country setbacks, there has also been major movement in the direction of democratic and more accountable government.

The region recorded real annual growth of 3.6 percent *(1.1 percent per capita)* over the 1991-98 period. This represented a significant improvement over the 2.6 percent annual increase *(0.4 percent per capita)* recorded over the previous 15 years. As a result of the adverse impact of the Asian crisis on the global economic environment through falling export prices and volumes, and reduced capital flows to developing countries, growth in Latin America slowed to 2.1 percent in 1998 and was virtually flat in 1999. Growth has subsequently rebounded to a projected rate of roughly 4 percent this year.

Although the pace of growth over the last decade is less than one-half of that recorded in Asia, it is still an important step in the right direction and was achieved against a background of financial crises, natural disasters, and fluctuations in commodity prices.

Latin America's economic growth has also translated into important social progress, e.g.,

- infant mortality rate has dropped from 61 per 1,000 live births in 1980 to 31 in 1998.
- Life expectancy at birth has increased from 65 years in 1980 to 70 years in 1998.
- Primary school enrollment has increased from 86 (male) and 85 (female) percent in 1980 to 95 (male) and 93 (female) percent in 1997. Latin Americans over 25 in the 1960s had only 3.2 years of education. This average reached 5 years in the 1990s.
- The percent of the population with access to sanitation *(sewerage)* has increased from 46 percent in 1982 to 68 percent in 1995.

At the same time, much remains to be done. Economic and social progress has been uneven both within and among countries, and Latin America's record in translating economic growth into poverty reduction has been very disappointing, e.g.,

- Latin American countries have the greatest income disparities of any region. The poorest 20 percent of the population receive less than 5 percent of total income while the richest 20 percent receive 53 percent.
- more than 15 percent of the population are living on less than $1 per day; more than 36 percent are living on less than $2 per day. *(Brazil accounts for almost 40 percent of the population below $2 per day.)* Unlike the East Asia and Pacific region where the incidence of poverty has been declining, these figures for Latin America remained roughly constant, with perhaps only a very slight decline, over the 1990s. The region is clearly not on track to meet the International Development Goal of reducing the incidence of income poverty by half by 2015.

While sound macro-economic policies are essential for the economic growth that is the most important determinant of countries' ability to raise incomes and reduce poverty and inequality, this must be accompanied by the right social sector policies to effectively achieve poverty reduction. Efforts to promote economic growth, poverty reduction, and economic inclusion should be mutually reinforcing. This is one of Latin America's most crucial development challenges as we enter the new millennium.

In addressing this challenge, we know some things about what contributes to equitable growth. For example, there is now a broad consensus on the need to focus more explicitly on attacking poverty, by concentrating resources and attention more effectively on the interventions that most affect poverty. Thus while it is crucial for the countries of the region to maintain sound economic management, they also need to prioritize investments in human development, particularly the provision of stronger and more efficient basic education and health services, and rural development, that expand opportunities for the poor.

The Role of the World Bank and IDB

Because Latin America's per capita income is relatively high compared to that of other developing regions, only a small portion of World Bank and IDB assistance is provided on concessional terms and this assistance is restricted to the region's poorest countries, currently Bolivia, Guyana, Haiti, Honduras and Nicaragua Over the last five years, total concessional lending by the World Bank's International Development Association (IDA) and the IDB's Fund for Special Operations averaged about $875 million annually *($365 million IDA + $510 million FSO)*. Bolivia and Honduras were the largest two recipients of both IDA and FSO resources, together accounting for just over one-half of the total.

The level of "hard loan" *(based on the institutions' cost of borrowing)* World Bank (IBRD) and IDB lending to Latin America varies annually. The long-term pre-financial crisis trend shows lending to the region relatively steady in the IDB (roughly $5.5 to $6.0 billion annually) and actually declining in the IBRD (averaging about $4.5 billion). In rough terms, the combined level of new hard loan lending commitments from the World Bank and IDB is normally around $10 billion annually.

- New IBRD commitments to Latin America declined from an annual average of $5.5 billion in FY 1992-93 to an annual average of $4.2 billion in FY 1996-97. During the recent financial crisis, lending reached $5.7 billion in FY 1998 and $7.2 billion in FY 1999. It is expected to drop sharply this year.

- New commitments of IDB ordinary capital lending exceeded $5 billion for the first time in 1992. Lending averaged $6.4 billion in 1995-96; falling to $5.7 billion in 1997. Lending reached $9.3 billion in 1998 and $9.1 billion in 1999 due largely to a substantial increase in assistance to help cushion the financial and development impact of the crisis on Argentina and Brazil and other economies in the region. Lending has now returned to more normal levels with lending for 2000 currently projected at about $6 billion.

In terms of net transfers, it is not unusual in the Latin American region as a whole for the aggregate repayments on hard loans plus interest and charges to exceed the level of new disbursements to hard loan borrowers. In the IBRD, the negative net transfer in FY 1997 and FY 1998 averaged $1.3 billion, although there was a positive transfer of $640 million in FY 1999 reflecting increased disbursements from crisis lending. In the IDB, the net transfer to Latin America was negative from 1990 to 1996, but has been positive since 1997 by an average of $2.1 billion annually as a result of increased disbursements from crisis lending.

Because of Latin America's increased ability to access private market financing, World Bank and IDB financing has declined in relative terms and now represents only a small share of total capital flows to the region. *(Over the last decade, the share of total loan disbursements to Latin America attributable to the MDBs has declined from over 30 percent to about 10 percent; while the share of private lending has increased from less than 50 percent to around 85 percent.)* Yet given their leverage with their borrowing members, the Multilateral Development Banks (MDBs) are well positioned to address the major economic weaknesses that both constrain countries' ability to attract private financing and undermine the sustainability of their long-term growth. There has also been a long-term shift in the focus of both institutions away from traditional infrastructure and energy projects and toward the social and financial sectors.

The effectiveness of MDB lending to Latin America varies by country. Overall, we believe the World Bank and the IDB have played a highly positive role in encouraging and supporting countries of the region to build economic frameworks necessary to make markets work more effectively and allowing private enterprise to grow. While countries themselves should take the ultimate responsibility and credit for their sound economic management, the MDBs have been indispensable helpful partners in promoting reforms in a broad range of areas which we now take for granted. These include allowing the market (not governments) to set industrial, energy, and agricultural prices; liberalizing trade and investment; prioritizing public expenditure on cost-effective programs; professionalizing and shrinking the civil service; reducing or eliminating public subsidies to public enterprises; privatizing and allowing private firms to operate in all sectors; reforming the banking sector through sound banking and credit policies; and advancing good governance by addressing corruption and promoting greater transparency, accountability, rule of law, and participation.

Argentina is a good example. Since 1991, when it began a dramatic turnaround in the management and performance of its economy, it has been the second largest Latin American borrower from both the IBRD (Mexico is the first by a small margin) and the IDB (after Brazil). Over this period, and in sharp contrast with past stagnation, economic growth averaged 5 percent per year. Total GNP doubled in real terms, and the economy was put on a sounder footing to address outstanding problems, particularly the stubbornly high level of unemployment and the need to improve certain social indicators -- such as income equity and poverty -- which have been deteriorating. Despite Argentina's relatively high per capita income ($8,970), approximately 35 percent of the population lack access to safe water with 25 percent lacking access to sewerage.

The World Bank's independent and highly respected Operations Evaluation Department (OED) recently evaluated the Bank's assistance strategy in Argentina. While the scale of the

World Bank's assistance (and that of the IDB) in a large and sophisticated economy such as Argentina is relatively small, the OED evaluation was highly positive in terms of the total impact of the Bank's supportive financial and advisory role to a highly committed government. Over time the Bank's program – which totaled $12.6 billion over the nine years -- evolved from support for public sector reform and privatization to support for financial sector reform, and then provincial reform, focussed at first on provincial finances and increasingly on social sector issues. During the 1998-99 Asian financial crisis, Bank assistance, by helping to minimize the contraction in public expenditures, contributed to protect social expenditures, as well as to mitigate the crisis's impact on the poor. This overall strategy was judged largely successful, with high rates of achievement of project objectives and low levels of portfolio problems. The institutional impact of the Bank's program was also evaluated as substantial and, with the reforms it supported now fully imbedded in the Argentina's institutional setting, likely sustainable.

Bolivia, the largest Latin American recipient of IDA and FSO concessional funds over the last decade, has also experienced a dramatic economic transformation. Emerging from a period of severe economic and social chaos, Bolivia has compiled an impressive twelve-year track record on stabilization and reform despite major economic constraints including weak institutional capacity, major infrastructure weaknesses, adverse terms of trade, and vulnerability to climatic/geological shocks. *(Although Bolivia's land area equals the combined area of California and Texas, there are only 2,400 kilometers of paved roads. Exports are heavily commodity-based and relatively undiversified, with manufactured goods accounting for less than 10 percent of exports.)* As is the case in Argentina, in Bolivia it is the strong commitment of successive democratically elected governments that has been decisive, although the IDA and the IDB, as well as other donors, have provided crucial support.

- Annual growth averaged 4.3 percent *(about 2 percent per capita)* in the 1990s; after being at negative levels during the 1980s.

- Inflation has been reduced from 24,000 percent in the mid-1980s to about 5 percent today,

- Privatization has reduced state-controlled enterprises from 25 percent of the economy in the early 1990s to less than 2 percent.

Unfortunately, the resulting impact of economic growth and reform on poverty has been modest. While some social indicators show improvement, for example, infant mortality has been reduced from 100 deaths per 1,000 to 65 per 1,000 in three years, some 70 percent of the population remain poor. The government is strongly committed to addressing this problem and is currently in the process of developing, with civil society participation and in concert with a parallel dialogue organized by the Catholic Church, a Poverty Reduction Strategy Paper (PRSP) based on "growth with equity". PRSPs set out clear strategies for addressing the key constraints individual countries confront in their efforts to reduce poverty. Preparation of a participatory PRSP presents a complex and difficult challenge, but if successful would constitute a major achievement and establish a firm basis for a more credible long-term attack on poverty. The PRSP process has the strong support of IDA and the IDB, as well as the International Monetary Fund, USAID and other donors, for whom it would constitute the basis for all future lending.

The World Bank and the IDB plan to continue to support economic reform in Latin America, recognizing that many countries are now in the most difficult phase of the reform process (e.g., major public sector, pension, budgetary, institutional and judicial reform, frequently at both the federal and local levels) where implementation is complex and difficult and the efforts needed to build the necessary domestic public and political consensus are time consuming and vulnerable to protracted delays. The region also remains vulnerable to external shocks. There is also major public concern about income inequality and the difficulty in securing sustainable progress in unemployment and poverty reduction. As a result there is danger that these could undermine economic and social support for the ongoing reform process. In response, the future programs of both the World Bank and the IDB will focus heavily on reducing countries' vulnerability to adverse developments in the international economy and financial markets, while also concentrating even more assistance on the social sectors *(e.g., health, education, and safety nets)*. As a recent World Bank study *(Securing Our Future in a Global Economy)* concluded, much more needs to be done by governments to protect the sustainability of social service programs during times of economic and financial crises. The fact that Latin America has a relatively young population also provides a window of opportunity to strengthen social security and pension reform.

The World Bank and the IDB have also played active roles in responding quickly to facilitate recovery and *reconstruction* from natural disasters, such as Hurricane Mitch in Honduras and Nicaragua, the January 1999 earthquake in Colombia, and the adverse economic disruptions throughout the region resulting from El Nino. Both institutions also have leadership roles in aid-coordination where they collaborate closely with USAID and other bilateral donors.

Heavily Indebted Poor Country (HIPC) Initiative

The United States has played perhaps the leading role in helping to design and implement the HIPC Initiative. The enhanced HIPC Initiative seeks to improve prospects for long-term growth and poverty reduction by reducing debt for the poorest countries that have demonstrated good economic performance, in order to provide a cushion against future debt problems and free up significant new resources for productive investments to reduce poverty. Bolivia was determined eligible for enhanced HIPC relief in January and Honduras is expected to become eligible in early July. Two other Latin American countries -- Guyana and Nicaragua -- are also potentially eligible. HIPC is not a cure for the poverty of these countries, but one of a number of programs -- including the provision of concessional IDA and FSO resources – focused on deepening a long-term sustainable effort at poverty reduction.

The link between HIPC debt relief and poverty reduction has been strengthened by the introduction of Poverty Reduction Strategy Papers, which are prepared by national authorities with broad popular participation, are now an integral part of the HIPC framework. We have been working hard to ensure the HIPC/PRSP process emphasizes sound economic management, health, education and other programs critical to poverty reduction, monitorable poverty reduction targets, good governance and transparency, and civil society participation.

Overall the HIPC program is expected to benefit up to 33 poor countries, most of them in Africa. The cost to the United States of participating in HIPC is $920 million over three years. This includes the $320 million cost of bilateral debt reduction and $600 million that will be added to funds provided by other donors to the HIPC Trust Fund to help offset the cost of debt relief for regional multilateral institutions such as the IDB that lack adequate internal resources for full funding.

An Administration request to help finance HIPC is pending before the Congress. Passage is crucial for the Initiative as a whole, but particularly for eligible countries in Latin America where an agreement negotiated last week among the IDB and its member countries to finance the IDB's full HIPC costs is contingent on U.S. financial participation. The agreement symbolizes strong regional and non-regional cooperation in the IDB. While some technical details must still be worked out, it is a significant step toward the implementation and financing of the enhanced HIPC program in Latin America. The IDB will contribute at least $850 million of internal resources to help support its total HIPC costs of $1.1 billion. The agreed framework will also provide at least $250 million to support the participation of sub-regional institutions in HIPC. Without a substantial U.S. contribution, debt relief for near-term candidates will not move forward. The Administration strongly supports debt relief for the world's poorest, most heavily indebted countries. However, the U.S. delay in funding is having significant consequences. Bolivia, a good reformer and strategic U.S. ally in coca eradication, has met the requirements to receive debt relief under the Enhanced HIPC Initiative. However, debt relief for Bolivia will not occur until the United States contributes to the HIPC Trust Fund. In addition, if we do not contribute, debt relief for the other Latin American HIPCs will not move forward. As Honduras is expected to soon become eligible, the need for a sizeable U.S. contribution to the HIPC Trust Fund is urgent.

It should be noted that the U.S. budgetary costs, in terms of annual funding appropriations, for financing World Bank and IDB operations in Latin America are very modest.

- We no longer request funding for either institution's hard loan windows because we believe their existing capital bases are adequate to sustain lending indefinitely.

- The United States is participating with more than thirty other donors in funding IDA, but the U.S. costs attributable to IDA operations in Latin America – in rough proportion to the region's share *($604 million)* of IDA commitments last year – are about $70 million annually.

- We last provided funding for the World Bank's International Financial Corporation in FY 1997. The IFC makes direct equity investments to promote private sector development, foreign investment, privatization, and efficient markets in developing countries. Latin America, with a total committed portfolio of $8.2 billion, is the largest regional recipient of IFC operations.

- This year's Administration request includes $16 million for the World Bank's Multilateral Investment Guarantee Agency. MIGA was established in 1988 to provide investment insurance (guarantees) against non-commercial risks in developing countries at market rates to private direct investors. Latin America has the largest regional concentration of MIGA's coverage.

- The latest replenishment for the IDB's FSO concessional window entails no new U.S. funding.

- This year's Administration request for appropriations also includes funding for two members of the IDB Group, the Inter-American Investment Corporation ($34 million) and the Multilateral Investment Fund ($25.9 million). The IIC provides long-term loans and equity investments in small- and medium-sized enterprises primarily in the smaller and poorer countries; the MIF focuses on catalyzing investment reforms through grants for technical cooperation, human resource development, and small (primarily micro) enterprise development as well as for micro-finance institutions.

Increasing the Effectiveness of the World Bank and the IDB

We are counting on the World Bank and IDB to continue playing a vital role in promoting economic growth and poverty reduction in Latin America. However, like all institutions, they can be improved and their capacity to respond quickly and creatively to the evolving requirements of their membership strengthened. Both institutions must be alert to the opportunities for strengthening their development effectiveness. And, as the situation in Latin America demonstrates, efforts that more effectively promote growth need to be combined with a strong governmental and institutional commitment to poverty reduction.

The Administration has worked hard with the members of the World Bank and the IDB, and with their managements, to promote reforms that improve their development effectiveness. We have been successful in achieving significant changes in many areas, for example,

- More transparency and accountability in the institutions and their operations;
- Increased attention to poverty reduction;
- Greater attention to lending effectiveness and project quality;
- More focus on governance and anti-corruption; and
- Increased attention to environmental sustainability and core labor standards.

The issue of institutional reforms has been highlighted by the recent Report of the International Financial Institution Advisory Commission and the Department of the Treasury's June 8, official response to the recommendations of the Report. As you know, Treasury disagrees in fundamental respects with the bulk of the Commission's reform prescriptions. I would like to briefly touch on three of these recommendations that are particularly relevant for Latin America: the recommendations to phase out lending to countries with annual per capita incomes above $4,000 or an investment grade international bond rating, to preclude the MDBs from financial crisis lending, and to shift World Bank operations to the regional development banks. In sum, we believe that these recommendations would eliminate the capacity of the World Bank and IDB to continue promoting economic reform and development in many Latin American countries that continue to face formidable development challenges.

- Because access to private capital for many of these countries is vulnerable to market disruptions and often unavailable in the volumes and terms appropriate for long-term development investments, graduation policies with a fixed and excessively low threshold risk worsening economic outcomes and increase the likelihood of future crises. This could undercut or prolong the path to sustainable market access, and ultimately delay the time when these governments will grow out of the need for official support.

- In those exceptional circumstances where crisis lending is appropriate, the emergency capacity of the MDBs can be essential to support an appropriate level of fiscal expenditures, to design and finance financial sector restructuring programs, and to further target assistance for critical social programs, such as education and healthcare.

- Eliminating the World Bank's financial role in providing development assistance would undermine the effectiveness of the overall development effort. Although the IDB has many strengths and plays a complementary role to the World Bank, it does not have the broad strengths of the World Bank across the development policy spectrum.

The Administration's Reform Agenda

Latin American and the Caribbean still confront formidable development challenges in achieving sustainable growth and poverty reduction. The overriding objective of on-going reform in the World Bank and the IDB is to put in place more effective ways for these institutions to help members address these challenges. We believe the most promising approaches for advancing this goal lie in the following proposals:

- Improved performance and impact: with the MDBs relying on a smaller number of measurable performance targets, with a stronger link between disbursements and performance progress, and lending concentrated on countries that are performing well;

- Emphasis on economic growth and poverty reduction: with the MDBs focusing higher levels of assistance in areas that have the highest development returns, particularly health care, basic education, rural roads, and water supply and sewerage;

- Focused hard-loan lending to emerging economies: with the MDBs exploring innovative ways to catalyze private capital and establishing more selective lending frameworks to facilitate graduation;

- Transparency: with a stronger presumption in the institutions to publish key loan documents and to establish increased transparency in their lending operations at the local level so that programs can be more easily monitored;

- Global public goods: with a stronger focus on solutions to the problems of infectious diseases and environmental degradation, and the use of information technology to create and disseminate knowledge; and

- Improved collaboration and selectivity: with further efforts to reduce operational overlap among institutions, speak more clearly on priorities, and share the lessons of experience.

<u>Conclusion</u>

In concluding Mr. Chairman, I would to emphasize the importance that the Treasury Department places on working to help assure that our neighbors in Latin American and the Caribbean are successful in their efforts to achieve sustainable growth and poverty reduction. This is very much in our own national interests.

The Treasury Department remains committed to working hard with the management and members of both the World Bank and the IDB to ensure these institutions are able to work effectively in supporting those borrowing governments committed to sound economic management and reform. The challenge of reenergizing efforts to combat poverty in Latin America is multi-dimensional. It is also difficult and complex. In a good policy environment, economic assistance - multilateral and bilateral - can and does make an important difference both in spurring growth and in reducing poverty. We will work closely with the Congress to maintain a selective and well-targeted effort in this area. Thank you.

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Testimony Before the Subcommittee on the Western Hemisphere
House Committee on International Relations
U.S. House of Representatives

Development Cooperation in the Hemisphere: Striving for Effectiveness

By Sylvia Saborio*
Senior Fellow, Overseas Development Council

June 28, 2000

Assessing the effectiveness of development assistance is a risky business. In the first place, because we are less confident now than we were a few years ago –when we still believed in the "Washington Consensus" and in the "East Asian Miracle"– that we know what it takes to produce "development". Secondly, because many of the outcomes of development assistance interventions are, by their very nature, intangible and long term. And thirdly, because exogenous factors have a way of intruding into the equation in ways that sometimes reinforce but often counteract desired outcomes, making it very difficult to attribute specific results to particular interventions.

Nevertheless, there is a sizable and growing body of lessons learned from the development experience that should enable us to better understand the essential ingredients that make for high, sustainable and equitable growth and to better judge and improve the quality of policy interventions.

In what follows, I will:

- present a synopsis of the state of development in the Latin American and Caribbean (LAC) region at the turn of the century;
- discuss some of the major challenges facing the region in the years ahead; and
- consider ways in which external actors can help the countries in the region effectively meet those challenges.

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* The views expressed are those of the author and do not necessarily represent those of the ODC as an organization, or of its individual officers, Board, Council or staff members.

Latin America at the Turn of the Century[1]

At the risk of over-simplifying the regional picture by abstracting from the tremendous diversity that it contains, in the interest of time I shall focus instead on the common threads that characterize the region.

- The rate of economic growth has been sluggish in comparison to world patterns for several decades. Average per capita income is currently around $3,100 –less than a third that of industrial countries and lower than that of East Asia, the Middle East and Eastern Europe. This wasn't always so: at mid-century LAC's per capita income was higher than that of all other developing regions and half that of industrial countries.

- Despite great strides in taming inflation in recent years, the region remains more volatile than other areas, in terms of unemployment, job insecurity and real income variability: indeed, the growth rate in any LAC country typically fluctuates 4 points in either direction in any given year! People who have not experienced such a roller-coaster must find it hard to fathom how anybody can live with such insecurity and vulnerability. The answer is, of course, not very well...

- Latin America also has the worst distribution of income in the world: a fourth of national income goes to only 5% of the population and 40% goes to the richest 10%. In South East Asia, the richest 5% receive 16% of total income, on average, and in developed countries the corresponding figure is 13%.

- The above indicators notwithstanding, in terms of the U.N.'s Human Development Index[2], LAC is on a par with East Asia and Eastern Europe and surpassed only by industrial countries, and this gap has been narrowing over time. Indeed, the region has made important strides in the area of health –notably, lowering infant mortality rates, raising life expectancy indices and virtually eradicating such diseases as polio– and has registered some modest gains in education as well

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[1] This section draws heavily on IDB's *Latin American Economic Policies*, Vol. 9, Fourth Quarter, 1999.

[2] A composite indicator made up of four indices: life expectancy, literacy rate, school enrollment and per capita GDP.

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(i.e. closing entirely the gender gap), although it continues to face serious problems of incompletion and quality that feed right back into lack of economic opportunity.

- In terms of social development, another paradox: while LAC has moved to the forefront of the developing world in terms of civil liberties and respect for democratic rights, individual violence has skyrocketed: crime rates –against both persons and property– are currently higher than those anywhere else, except Africa.

- Finally, the initial enthusiasm that met the tide of democratization that swept the region over a decade ago has began to erode on the face of disappointing economic and social outcomes. While democracy has increased people's freedom to criticize unresponsive bureaucracies and inefficient spending, it has not necessarily helped to solve these problems. Nor has it succeded in stemmming new threats, such as terrorism, gun and drug traficking, money laundering and corruption.

Major Challenges Facing the Region

It is clear from the mediocre record of accomplishments just noted that the region faces major challenges in the economic, social and political spheres.

- In the *economic* sphere, the so-called "first generation" of structural reforms – notably, liberalization of imports, the capital account of the balance of payments and the domestic financial system, privatization of public enterprises and tax reform-- pursued over the last 15 years or so, have produced outcomes that fall far short of expectations. A recent study by ECLAC[3] concluded, *inter alia*, that:

    - "Overall, ... the reforms have had a surprisingly small impact...a small positive effect on investment and growth and a small negative impact on employment and income distribution..."

    - "The reforms did not solve, and quite probably increased, two problems: investment continued to be concentrated among large enterprises that have not shown the capacity to develop backward or forward linkages with smaller firms, and supplier chains were destroyed by the quest for competitiveness through increasing imported imports".

    - "The majority of foreign direct investment...went to purchase existing assets, either through privatization of public firms or takeovers of private

3 Stallings, Barbara, and Peres, Wilson, Growth, Employment and Equity: The Impact of the Economic Reforms in Latin America and the Caribbean, *Summary*, ECLAC, Spring 2000.

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corporations."

Clearly, the next generation of reforms must be more pro-growth, and more pro-poor. At the macro level, stability needs to be consolidated and the resource allocation improved, and at the micro level, tendencies toward polarization and concentration must be constrained, if not reversed.

- In the *social* sphere, there are at least three areas where further action is needed:

    - Employment generation. Employment has been squeezed on two fronts: recent shifts in relative prices have favored capital-intensive production and import competition has wiped out a host of small, relatively labor-intensive producers. The "informalization" of employment is not a socially desirable option: alternative employment opportunities in the formal sector must be developed. In this regard, affirmative actions to create an environment where efficient, small production units can thrive is the most promising way to generate employment and improve the primary distribution of income

    - Social spending. LAC has a lot of catching up to do in terms of human capital accumulation: ensuring greater and more efficient social expenditure, especially in education, must be a priority.[4] Mechanisms must be found to improve the delivery and financing of social services in ways that do not segregate access and quality according to social strata and that protect social expenditures from cyclical downturns.

    - Social protection. In a region subject to as much volatility as LAC is, safety nets are a must.

- Last, but certainly not least, in the *political* realm, issues of governance and institutional development are a major and urgent challenge. Indeed, in my view, this is where LAC has the greatest deficit.

  Far-reaching institutional reforms are needed to enhance both economic efficiency and social equity, as well as to facilitate the interface with others in the hemisphere and beyond, in a rapidly globalizing world. This is a societal issue that trascends the government itself. In the public domain, mechanisms for decision-making, conflict resolution and accountability need to be improved, and the institutional capacity to carry them out, enhanced. In the corporate sector, socially responsible entrepreneurship must replace the clientelistic, rent-seeking behavior of yesteryear. And civil society must find a

4 In this regard, see Joan Nelson's Reforming Health and Education: The World Bank, the IDB and Complex Institutional Change, ODC, Policy Essay # 26, 1999.

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coherent voice and a constructive role to play in this new scheme of things.

Role of External Actors

While LAC must remain the main protagonist of its own development, external actors can and should play an important supporting role, basically in three areas:

- Enabling environment. Particularly now that the region has embraced an outward-oriented, market-based development strategy, in order to succeed, it requires open markets and a stable international financial system.

  U.S. leadership is essential in this regard. On the trade side, It should secure fast-track authority so that it can engage in serious negotiations with regional partners toward the completion of the FTAA by 2005, and so that it can credibly push for global trade negotiations in the WTO. On the financial stability side, the U.S. should bring its considerable weight to bear on the G-7 and on the IMF in order to improve both the mechanisms for crisis prevention and crisis management[5] As part of this crisis prevention and management approach, the U.S. should also weigh in on the private financial sector to improve risk management practices and exercise corporate responsibility.

- Development Finance. Meeting the region's hefty needs in terms of physical, human and social capital is going to require the mobilization of considerable resources, from both domestic and external sources. The particular resource mix needed will vary widely from country to country, depending on size, stage of development and particular circumstance. But in most countries, public funding is still needed to crowd in private funding.

  The IDB and the World Bank have important roles to play in supplying some of these funds. Recent analyses suggest –and my own experience with both of these institutions confirms—that there is vast room for improvement in the way they perform their development finance function. In my view, this is true of the way they allocate their corporate resources and their loan portfolio, as well as of the way they handle the project cycle, from design to monitoring and evaluation. Corporate incentives are skewed in favor of loan approvals and, partly as a result of that, smaller borrowers tend to get short shrift in terms of the allocation not only of funds, but of high quality personnel as well. And, since the risks are ultimately borne by the borrowers, there are no self-correcting institutional mechanisms in place to set matters straight.

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5 See ODC Task Force Report on the Future of the IMF, 2000.

These are not arguments for closing down these institutions, but rather for improving them. And to be fair, the mounting criticism is beginning to have an impact. I am not a great believer in the Comprehensive Development Framework and the way it is being applied –I find it a bit too grandiose, involving too many actors and prone to overload existing institutional capacities-- but clearly, some sort of organizing principle is needed to set development priorities and see to it that they get financed. Time will tell if CDF is the answer… or the problem! And similar misgivings apply to the Poverty Reduction Strategy process linked to the HIPC initiative.

Bilateral development assistance also has an important role to play in some countries in the region. Claire Short, the British Secretary of State for International Development, recently declared that the European Commission is "the worst development agency in the world".[6] That may be so, but it has company.

A study of USAID I recently conducted led me to conclude that the system of resource allocation is so over-determined –through an incredible array of ceilings, floors and earmarks imposed by the Congress—that the exercise in strategic planning and management for results attempted by the Agency is rendered largely useless. The effectiveness of U.S. development assistance is further compromised by the fact that a large proportion of U.S. bilateral aid is tied –3/4 vs. 1/4 for the DAC as a whole. A recent World Bank study concludes that tied aid reduces the value of development assistance by 25%.[7] Last, but not least, of course, is the fact that, at 0.10% of GNP, the U.S. has the lowest development assistance ratio in the DAC. This is unconscionable, at a time of unprecedented prosperity.

[In the interest of time, I did not address directly the issue of how to increase the effectiveness of aid. But ODC has a robust body of work in this area and I have supplied some of the materials prepared by my colleagues.[8]]

- Ideas. Finally, a very important component of the development

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6 The Financial Times, June 23, 2000.

7 Assessing Aid—Overview, http://www.worldbank.org/research/aid/overview.ht

8 See Kanbur, Ravi, Sandler, Todd with Morrison, Kevin, The Future of Development Assistance: Common Pools and International Public Goods, ODC Policy Essay # 25, 1999; and Sewell, John "The Changing Definition of Development and Development Cooperation", presented at USAID's Conference on "Making a World of Difference: Celebrating Thirty Years of Development Progress", June 29, 1998.

assistance package is not money, but ideas. Here we need to be creative and eclectic. Development paradigms come and go, but in the process they affect real people. We need more research and more technical assistance to share best practices and best policies more widely and, in so doing, reduce the overall cost of development.

In closing, I would like to thank the Subcommittee on the Western Hemisphere for this opportunity to share my views and concerns regarding LAC, and at the same time, make an appeal to give the region more than the intermittent attention it usually gets. After all, LAC is already the U.S.'s most important trading partner, accounting for 45% of U.S. exports and 36% of its imports. And, we are engaged in the process of creating the largest –and hopefully most prosperous—partnership in the world. The framework for hemispheric cooperation is already there, agreed at the Miami and Santiago Summits: now all we have to do is make it happen!

Testimony

House Foreign Affairs Committee
Subcommittee on the Western Hemisphere

June 28, 2000

Colin I. Bradford, Jr.

Professor of Economics and International Relations
American University

It is an honor to discuss with you issues of aid effectiveness in Latin America. I appreciate the opportunity to be here today and your interest in these matters. I have been professionally involved in development issues since first going to Latin America in 1962 to be a high school teacher in Bogota, Colombia. Latin America is extremely important to the United States and your attention to our development cooperation relationship with Latin America is to be applauded by all Americans who understand how important this region is to our own prosperity and prospects.

I am going to focus my remarks on three issues. First, I will place the aid effectiveness issue in an international framework so that you can appreciate the degree to which U.S. assistance through bilateral and multilateral channels is part of a broader international effort. Second, I will discuss the current context of pessimism about Latin America's recent performance in the wake of economic policy reforms and the resurrection of democracy in the region within the current climate of public opinion of what might be called "globalization backlash". Third, I will suggest some conclusions as to what can be done, or what should be done, to improve the sense in the United States that what we do in development assistance toward Latin America matters and is worth it.

I. U.S. Development Assistance and the International Development Cooperation Effort

On Monday of this week, the follow-up from the Social Summit held in Copenhagen five years ago opened in Geneva. A landmark report was issued in Geneva on Monday as part of the inaugural ceremonies. This report is of direct concern to this Subcommittee: 2000: A Better World for All; Progress towards the International Development Goals. The report is the first report ever published that carries the signatures of the heads of the World Bank, the International Monetary Fund (IMF), the United Nations, and the Organization for Economic Cooperation and Development (OECD). It tells a remarkable story. First, it is a story of hope and of progress towards ambitious goals for the human community. And second, it is a story about the degree to which the development efforts of the world are pulling in one direction, toward one set of goals, in a way that progress and retrogression can be monitored, reported and acted upon. It is, in a word, a report on aid effectiveness. I have made copies available to the Subcommittee for this hearing.

What is important about this report for your concerns is that: (1) it demonstrates that progress *is* possible; (2) it shows convincingly how different elements of the international development assistance effort under your purview *reinforce* each other to achieve the same result -- a reduction in poverty; and (3) it vividly demonstrates that the concerted effort by all bilateral and all multilateral development programs are marshalled toward the same objectives so that individual national efforts, like that of the United States, *synergize* with that of others so that the whole is greater than the sum of the parts.

Therefore, you are quite right to hold this hearing not just on the Latin American programs of our own bilateral assistance program through the U.S. Agency for International Development (USAID) but also to include the multilateral assistance programs toward Latin America supported by the United States through the World Bank, the Inter-American Development Bank (IDB) and the International Monetary Fund (IMF), supervised by the Treasury Department. This focus is appropriate to the fundamental perspective needed for U.S. development assistance to be effective; that is to understand that the efforts the United States is making is part of a larger international effort involving in the first instance the efforts of the developing countries themselves; second, the effort of our partners in Europe, Japan, Australia, New Zealand and Canada; third, the multilateral development institutions such as the United Nations Development Program (UNDP), the World Bank, the IMF, and the IDB, and fourth, the new development cooperation efforts by developing countries themselves of which there are now some 15 middle income developing countries providing development assistance to poorer countries, as they have graduated from aid receivers to aid providers.

How does this development effectiveness process work? What are the goals? Where did they come from, and why will these goals help make more progress with limited resources?

The goals are: (See page 25, the inside of the back cover, of 2000.)

1. Reduce by half the proportion of people in extreme poverty by 2015.

2. Achieve universal primary education in all countries by 2015.

3. Reduce by two-thirds the mortality rates for infants and children under five by 2015..

4. Reduce by three-fourths the mortality rates for mothers by 2015.

5. Demonstrate progress toward gender equality and the empowerment of women by eliminating gender disparities in primary and secondary education by 2005.

6. Provide access to reproductive health services for all individuals of appropriate age no later than 2015.

7. Implement national strategies for sustainable development by 2005, to ensure that the current loss of environmental resources is reversed globally and nationally by 2015.

("Democratic accountability, the protection of human rights and the rule of law…are essential to the attainment of the more measurable goals." [OECD/DAC May 1996; page 11])

The important thing to note about these goals is that they reinforce each other. Improving gender equality in education, improves women's health, their productivity, their nurturing of the next generation, their stewardship of natural resources and their incomes, just to take one clear example. Because of their reinforcing character, this set of goals is not just a laundry list of desirables; *the goals constitute a strategic vision for the global development effort*. They are not just an accounting system for measuring progress; they constitute the policy priorities of the international community in the pursuit of human dignity for all. They guide the policy and the programs of nations, of NGOs, and of donors. The goals are the heart of the development cooperation effort; they put all the major actors on the same page; consequently, *they are the centerpiece of the development effectiveness process.*

These goals derived from the recommendations from the UN Summits on the environment (Rio), population and development (Cairo), poverty (Copenhagen), human rights (Vienna), and women (Bejing). *They have all been agreed to by the governments of the developing countries and the industrial nations.* So these are not goals that think tanks or international agencies came up with but are genuinely accepted goals of national governments, including our own. Following the Summits,these specific goals were selected as priorities in a year long deliberative process among senior officials and Ministers of Development Cooperation of the bilateral development cooperation agencies from industrial countries as they confronted the need for a compelling vision for development cooperation in the Post-Cold War period. This vision by Ministers of Development Cooperation and Heads of development agencies of OECD industrial countries was issued in May 1996 at their High Level Meeting (HLM) in the OECD Development Assistance Committee (DAC), which is the body for donor coordination among industrial countries. Their vision was endorsed by their Ministers of Finance and Ministers of Foreign Affairs at the OECD Ministerial in the Spring of 1996 and by Heads of State at the G-7 Summit in Denver in July of 1997 and still more strongly in the G-7 Summit in Birmingham (UK) in July of 1998. Meetings were held with leaders of developing countries in various venues throughout this process. The goals were an important part of the first ever discussion with 13 developing country donors agencies in Mexico in 1997. So this has been a *political process* throughout, engaging governments, expressing their will, codifying their priorities, galvanizing a truly international effort to sharpen the vision of where we need to go and what we need to do to get there. It has not been a technocratic process driven by bureaucratic or special interest concerns.

A major characteristic of the seven goals is that they are quantifiable. They can be monitored to check the degree to which progress is being made or not in fulfilling these goals. In this sense, in addition to being a strategic vision for the development effort, they are also the means by which we can *measure results*. That is what you have before you in the World Bank, IMF, UN, OECD report 2000: A Better World for All; Progress towards the International Development Goals. This is a collaborative statistical effort by the four international institutions to track global progress towards or away from the seven goals as a means of measuring effectiveness and as a means of measuring effort. The World Bank began in 1997 a new annual publication, World Development Indicators (WDI), in which the opening chapter each year measures development progress against the seven international development goals. There is an annual reporting process from this statistical effort to political leaders at the DAC HLM for Ministers of Development Cooperation in the spring and at the G-7 Summits for Heads of State in the summer. So, *the global aid effort is now accountable in terms of aid effectiveness in achieving results in a new and comprehensive way.*

II. Doubt about Latin American Performance and the Globalization Backlash

The international goals have been established against the background of extremely positive trends in the results variables over the last thirty years. Between 1968 and 1998: (USAID: 1998)

--The percentage of people living in absolute poverty has been cut almost in half.

--Girls&women have significantly closed the gap in gender disparity in education.

--Literacy has risen by almost 50 percent.

--Infant mortality has been halved.

--Life expectancy has risen by more than a decade.

--The average woman now has 3, not 6, children.

Therefore, the international goals are ambitious but within reach based on past experience.

Latin America is making progress toward the goals for the region, according to the <u>2000</u> report:

**The primary school enrolment rate has increased from 84% in 1990 to 94% in 1998, ahead of the trend line toward 100% in 2015. (page 8) Only 5 million of the 113 million children out of school in the developing world are in Latin America. (page 9)

**Latin America has already exceeded the gender equality goal with more girls than boys enrolled in primary and secondary school. (pages 10-11)

**Infant and child mortality rates (the lowest in the developing world) decreased from 49 deaths per thousand in 1990 to 37 in 1998, though below trend toward 16% by 2015. (page12)

**Of the 514,000 maternal deaths in the developing world in 1995, only 22 thousand were in Latin America. The proportion of births attended by skilled health personnel rose from 70% in 1988 to 77% in 1998, though below trend toward 90% by 2015. (pages 14-15)

**In 1993 66% of married women in Latin America were using contraception, higher than all other developing regions except East Asia & the Pacific. (page 16)

**Energy use and greenhouse gas emissions in Latin America are generally below trend, implying environmentally efficient production technologies. (page 19)

The concern in Latin America derives from the slow rate of poverty reduction, despite these positive trends in social improvement, and the slower than expected rate of economic growth in the region in the 1990s following the major economic policy reforms undertaken in the region in the 1980s. This slow progress is shown in the fact that the proportion of people in Latin America living on less than $1 a day has declined from 17% in 1990 to only 16% in 1998. (page 6) Nearly 80 million people in Latin America live on less than $1 a day. (page 7) Economic growth in selected reforming countries in Latin America (Argentina, Bolivia, Chile, Peru, Brazil, Colombia, Costa Rica, Jamaica and Mexico) which had averaged a real GDP growth rate of 6 percent from 1950-1980 only averaged 3.2 percent in the 1991-1998 period. (ECLAC:2000; page 37)

The questions being asked by this Subcommittee and by people throughout the Western Hemisphere is why have the reforms and the return to democracy in the region have not generated a greater response in economic growth and poverty reduction.

That is a difficult question to answer and the answer(s) surely differ from country to country. But I think there are two related answers that those of us outside of Latin America should contemplate. First, is *patience*. We are expecting quicker responses from measures that take time to embed their transforming effects in the economy and in the society. This is especially true of democracy. The return of elected governments to power in Latin America is not necessarily a sufficient condition for the return of democracy in the full sense of the term. We in the West made the mistake of thinking that the end of communism and the totalitarian state in the former Soviet Union meant that a market economy would spring into being to fill the voids. Economists made the mistake of thinking of the market only as a price mechanism. We forgot about, or ignored, all the institutional underpinnings that are necessary for a fully functioning market economy to work. Even in industrial economies, markets are imperfect. Similarly, we impatient Americans tend to want rapid change and immediate results. Democracy is a long gestating investment which requires rule of law, independent judicial systems, free press, and clear election procedures, among many other institutions, in order to function fully. These democratic processes and institutions are vital to achieving broader benefits for the least advantaged peoples of Latin America and to achieving more dynamic economic growth.

The second answer is related to this. The reason why democracy is so critical to economic and social goals of the region is because the *asset inequality* in Latin America is so skewed toward the rich, the privileged and the powerful. It is not just a question of income distribution but of the structural distribution of financial assets, of land and of human capital or education and skills. *The skewed income distribution results from the skewed asset distribution. The skewed asset distribution gives rise to skewed representation in government and other institutions.* Therefore, the economic and the political challenges are bound together. Without greater voice for the poor majority in politics, there will not be a shift in the ownership structure of assets which is vital to broadening the benefits of economic growth. There needs to be a process of opening access and opportunity for the poor majority to avail themselves of education, healthcare, credit for business development, savings and investment vehicles (pensions), and land.

Without these shifts, the production and productivity potential of the poor majority will not be able to contribute to the national economy, growth will be slow, and poverty reduction will stagnate.

The first generation of reforms in Latin America were largely economic and primarily in macroeconomic policy to achieve price stability and balance of payments equilibrium. They were needed reforms, and they were successful in achieving their goals which were largely financial in nature. They were not explicitly pro-poor, growth oriented reforms; they were anti-inflation, debt reduction, state-downsizing reforms. We cannot expect high growth, high employment and poverty reduction to follow from these first generation reforms. *The urgent agenda for the hemisphere now is:* (1) to stay the course in the institutional strengthening of democracy at all levels and in all dimensions to increase majority participation in public life and (2) to integrate the social agenda fully into the second generation of economic policy reforms in the region and in the development cooperation programs toward Latin America.

This sense of malaise about the efficacy of reforms in Latin America to achieve anticipated results dovetails with a general backlash against the globalization process in recent months, beginning at the WTO Ministerial meeting in Seattle and continued during the IMF-World Bank spring meetings in Washington, D.C.. The sense is that the globalization process is essentially a market liberalization process which favors the rich and corporate interests over the poor in developing countries and working people in industrial countries and over environmental concerns in all countries. The backlash is troubling because it threatens to rollback the hard won economic reforms of recent years and reduce the role of the international institutions just as they are increasingly needed. The perceived sluggish response of Latin America to market oriented reforms and the return to democracy seems to feed the globalization backlash which doubts the basic model of market democracies that the United States and other industrial countries have been pushing.

Therefore, the leadership you provide in staying the course in democratic development in Latin America and in pressing for more attention to pro-poor, pro-growth second generation policy reforms in Latin America, insisting on integrating the social agenda more fully into economic policy, will be an important marker in the debate about globalization and its discontents. It will provide the kind of time perspective and comprehensive outlook to the international policy debate that is needed. You will have provided leadership by demonstrating the broader commitment of the United States to political and social goals as well as economic priorities and to employment-generating, social inclusion economic policies that go beyond the preoccupation with financial stability so important to investors.

You can press the international institutions and US policy makers involved in them to be more responsive to developing country ownership and initiative in development strategies rather than using the IFIs as instruments to push a narrow paradigm of one-size-fits-all economic policies that generate resentment in other governments, reduce aid effectiveness and instill antipathy in our own publics who are concerned about poor people and poor countries. *Good policy paradigms should be regarded as menus that developing country governments can select from rather than recipes that must be followed from soup to nuts.* This is an important distinction that can go a long way to enhancing aid effectiveness, reducing alienation and increasing support for the development effort and the international institutions that are such important actors in it.

III. What Can Be Done to Improve Aid Effectiveness?

The 1980 Development Assistance Committee (DAC) chairman's report by former Princeton Economic Professor John P. Lewis devoted a chapter to "The Important but Elusive Issue of Aid Effectiveness"! In it, "two brands of aid politics that seem to characterize DAC Members" were described. "In one set of countries there is a pattern of positive reinforcement, wherein publics, committed to the development priority, push parliaments, which push governments which not only run dynamic programmes but engage in vigorous public education efforts that inform and refresh public support. In another set *the circularity is negative*: administrators feel constrained by parliaments, which feel constrained by indifferent or preoccupied publics--which the administration lacks the mandate or budget to inform very fully about development needs and issues." (OECD/DAC:1980; page 66, emphasis added)

Well, Mr. Chairman, having been Chief Economist of USAID from mid 1994 through mid-1998, it is not hard to discern which group the United States might be in! It is interesting to realize that the United Kingdom is clearly in the first set of countries. Yet,our country, our people, our government are not that different from the British. But in aid politics, the British are in a situation of positive circularity, as is evidenced by a recent speech here on the Hill by the Permanent Secretary of the U.K. aid program, Sir John Vereker. (18 April 2000) The issue of doubt about aid effectiveness cuts a different way in our aid politics than it does in other countries. ***The question I would like to raise is how we could shift US aid politics from negative to positive circularity.***

I am extremely hopeful that the political process that has led to the affirmation of international goals by all governments around the world, the strong support by all bilateral and multilateral donors to the common strategy embodied in those goals, and the international monitoring capability that we now have with the unprecedented cooperation between the four premier international institutions together *set in motion a process which can shift from negative to positive circularity for the United States*. Our NGOs are becoming more active; our public seems comfortable with international involvement; we now know how to achieve results; and we have a development cooperation process in motion from the field level to heads of agencies, from Ministers to Heads of State and parliaments that can demonstrate pulling together toward the same goals and aid effectiveness in achieving them. ***There is an unprecedented degree of cohesiveness and coordination among donors today that should reassure you and parliamentarians around the world that aid matters and aid works.*** I am extremely hopeful that this new global consensus can change the chemistry between the Congress and the Executive Branch in the United States so that the United States may join the UK, the Nordics, the Dutch and others who have positive circularity in their parliamentary relationships. This would help restore American leadership to development diplomacy once again. As Sir John Vereker states in the last line of his speech in the Rayburn Building in April: "we hope the US will *once more* take a leading role in this effort".

We have indeed fallen behind not only in volume but in leadership. I, for one, think that rotating international leadership positions among the best qualified people regardless of nationality is a good principle. But I must point out that in the last few years we have for the first time in fifty years lost the chair of the DAC because of the stronger volume performance of the Europeans taken together; and we have lost the Administrator position of the UNDP and the External Affairs Vice Presidency in the World Bank. The Europeans have demonstrated more cooperative parliamentary relations than we have been able to muster so that deservedly they are taking the leadership in voice and volume as a result. I welcome their strong leadership. But I think we need to realize that they need our strong leadership. We are failing ourselves, the poor in developing countries and our development partners in Europe and elsewhere by not getting our internal act together. So, *changing the aid politics, especially the chemistry between the Congress and the Executive, to positive circularity should be on all of our agendas*, regardless of where we sit. I trust you, Mr. Chairman, and members of this subcommittee feel the same way.

Therefore, with reluctance I turn to the issue of aid volume. ***It is simply the case that the central issue in aid effectiveness today is aid volume.*** We cannot expect to have an impact on the great human challenges embodied in the international goals without putting substantial resources into the effort. To be sure, aid effectiveness is driven by qualitative matters concerning direction and efficiency, but it is also determined by how much we do. ***We cannot expect grand results from meager investments.***

The budget request for USAID is $736 million for FY 2001. Jerome Levinson and Juan de Onis in their 1970 book on The Alliance that Lost Its Way have calculated that the AID total for fiscal years 1961 through 1969 was $4.4 billion or $490 million per year during the 1960s. (Levinson & de Onis: 1970; page 138) A conservative adjustment of these nominal aid figures for inflation would indicate that in current dollars the average 1960 annual AID figure for Latin America would be at least $2.5 billion. Or to deflate back to 1960s dollars, the current $736 million would be about $147 million in 1960s dollars. In either case, ***USAID funding for Latin America today is roughly 30 percent of what it was in the 1960s in real terms.***

In addition, population in Latin America in 1970 was estimated at 275 million; today it is 500 million people. Even if we had maintained USAID levels for Latin America, the aid per head ratio today would be roughly half what it was in the mid-1960s. Further, the size of the economies of Latin America are two and a half times today what they were in 1980. Even if we had maintained USAID levels for Latin America since 1980, aid as a percent of Latin American GDP today would be 40% of what it was in 1980. Therefore, ***in per capita or share of Latin American GDP terms, USAID budgets today are roughly 15% of what they were in the 1960s.***

Yet our goals are ambitious. We want to reduce the proportion of people living in poverty in Latin America by half between 1990 and 2015. Clearly, aid effectiveness in reaching this and the other international goals will be driven in significant measure by aid volume. As a society, as a government, as a nation, to be effective with our aid we must reverse the current trends toward less and less aid in real terms while the economies and populations of the impacted societies in Latin America are growing at rapid rates. If we want voice in the international development effort, in the shaping of the world of tomorrow, the United States will need to increase aid volume in a significant way. This will be welcomed by poor people and poor countries, by our donor partners and by our own people.

Finally, I have one more thought on ways to improve aid effectiveness. Aid coordination has become a crucial ingredient to aid effectiveness. Given a common international framework, would it not be a good idea to have the Congress suggest that every two years, under rotating chairmanship, there be a meeting of senior officials from the Inter-American Development Bank, the LAC region of the World Bank, the Latin American Bureau of USAID, the UNDP and other development agencies to review patterns of aid expenditure, trends in volume, and policies to assure coherence and coordination. A report could be prepared by the Council on Integrated Development of the Organization of American States as background for the meeting. A group of prominent analysts from Latin American should participate as critics and commentators. A revised version of the report could be submitted to Heads of State before the biannual Summit of the Americas as inputs into those meetings. And copies could be available to the U.S. Congress and other OECD Member parliaments. This would assure a regional focus on development cooperation and coordination as well as provide a useful document for evaluating aid effectiveness in donor country legislatures. This would help create a better information base for developing "positive circularity" on the issue of aid effectiveness among the development partners of Latin America.

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Note: Thoughout this text the term "Latin America" refers to Latin America and the Caribbean.

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