

Poverty Reduction in South America: The Millennium Goal within or Beyond Reach?

Stefan de Vylder
Stockholm, June 2002

Report commissioned by Sida
(Swedish International Development Cooperation Agency)



SWEDISH INTERNATIONAL DEVELOPMENT
COOPERATION AGENCY

Department for Latin America

Introduction	3
Chapter 1. Poverty.....	5
A Multidimensional Concept.....	5
Income Poverty in Latin America: Widely Varying Estimates	5
Poverty in South America: Incidence and Recent Trends.....	6
Human Development Indicators	7
Who are Poorest?	8
Cyclical and Permanent Poverty.....	9
Poverty Reduction Begins with Children.....	10
Economic Growth and Poverty Reduction: a Dual Relationship.....	10
Poverty Reduction is Good for Growth	11
Chapter 2. Economic Growth: Achievements and Constraints	12
Growth of Income and Production.....	12
Savings and Investment.....	14
Trade Performance	15
The External Sector: Muddling through, or a New Debt Crisis in Sight?.....	16
Education and Human Capital.....	18
Crime and Violence	20
Chapter 3. Income Distribution and the Role of Social Spending and Security Nets in Poverty Reduction	22
The Cyclical Behaviour of Income Distribution.....	23
What Should Be Stabilised, and Who Should Be Protected?	24
The Need for Countercyclical Policies.....	25
Chapter 4. Conclusions and the Role of Development Cooperation	33
The Poverty Reduction Goal.....	33
International Trends: Declining ODA to South America	33
Swedish Development Cooperation.....	34
Recommendations	35
Institution-building and "Niches"	35
Poverty Alleviation Begins with Children	36
Budget Support and Debt Relief?	36
Geographic Concentration?	37
"Water where it Grows"	37
Annex 1	38
The Millennium Development Goals	38
List of references.....	39

Introduction

The main purpose of the present report, commissioned by Sida as an input to Sida's strategy for Sweden's development cooperation with South America, is, according to the Terms of Reference, to "define the main obstacles to reach the Millennium Development Goals in the region". In particular, the focus is on the goal of reducing by one-half the share of the population living in extreme poverty by the year 2015.

In addition, the report shall identify instruments to address these obstacles, and evaluate possibilities for development cooperation between Sweden and the South American countries.

The paper begins with a brief discussion of poverty. Although poverty is a multidimensional concept, covering a wide range of material and social deprivations, the emphasis in this paper is on the more limited concept of income poverty.

Since any reduction of income poverty must be the result of either economic growth, expressed in rising average incomes, or reduced inequality, or an appropriate combination of the two, the report will concentrate on

- economic growth: past achievements, and lack of achievements, and major obstacles to accelerating growth; and
- income inequality: underlying causes, present trends and possible policy instruments.

The paper ends with a highly tentative discussion of suitable areas for future Swedish development cooperation with South America.

Since the writer of this paper is an economist, and the main topic is growth and income distribution, most of the discussion will concentrate on economics. But before turning to conventional economic variables and salient trends I would like to stress, as a point of departure, that it is my contention that the major obstacles to sustained poverty reduction in South America are of a political and institutional nature.

In a short paper like this it is necessary, but difficult and often very unfair, to generalise about the South American countries and about their respective traditions, governments, institutions and social movements. A problem like corruption, for example, is highly country-specific; it has never been a big problem in Chile, while it is a serious development constraint in a number of other South American countries. To do justice to this and other issues related to governance and institutional capacity would require country-specific analyses which fall beyond the scope of this short paper. I apologise.

The fact that this paper deals more with economics than with politics and institutional development does not mean that the latter aspects are less important – only that space is limited, and that the main focus is on economic factors.

A statistical caveat: the present report should cover South rather than Latin America, and much data will be presented for each of the major South American countries. Some figures will, however, refer to averages for the entire region, i.e. the whole of Latin America and the Caribbean (LAC). Especially when comparisons with other developing regions are made it is vital to use the same source, for example the World Bank's annual *World Development Report*, where many statistical tables use "Latin America & Caribbean" and not South America.

The bias introduced by not excluding Mexico, Central America and the Caribbean is usually not very serious, however; over longer periods of time, the differences (in per capita growth, etc.) between the LAC region and South America are not very significant. Mexico, however, has had a somewhat better performance in some respects (in particular growth of exports) which, given the large size of the Mexican economy, will introduce an upward bias if aggregates referring to the whole LAC region are used. On the other hand, economic developments in Central America and the Caribbean tend to fall short of the regional average in several respects.

Chapter 1. Poverty

A Multidimensional Concept

Poverty has many different, and overlapping, aspects. In addition to material poverty – lack of adequate food and shelter and access to basic consumer goods – and low education, people living in poverty often face high vulnerability to ill health and premature death and to environmental hazards. Material deprivation also tends to be accompanied by lack of power and voice in society, as expressed in low social status and exposure to neglect or bad treatment by institutions of the state as well of civil society.

A pervasive sense of economic and social insecurity, and a lack of capacity to cope with adverse shocks, are other common characteristics of people living in poverty, especially in societies where traditional safety nets – such as networks based on extended families and kinship – have been eroded and where public spending on social security largely bypasses the poor.

A comprehensive analysis of poverty would need to take all these different aspects into account. As indicated in the introduction this paper will, however, concentrate on statistically more accessible measures of poverty related to income and to various social indicators.

Income Poverty in Latin America: Widely Varying Estimates

The Millennium Development Goal of reducing by one-half the number of people living in extreme poverty refers exclusively to material deprivation, as measured by income poverty.

Income poverty is most commonly defined as insufficient income to buy a minimum basket of goods and services. The indicator usually associated with income poverty is the “headcount ratio”, which gives the proportion of people or households whose income falls below a particular poverty line.

The poverty line is often set at two USD per person and day, expressed in purchasing power parity (ppp) to adjust for differences in prices between different countries.

The internationally most commonly used indicator of extreme poverty – and which the Millennium Development Goal refers to – defines the poverty line as one ppp-dollar per person and day.

Unless otherwise stated, these are the measures of “poverty” and “extreme poverty” that will be used in this report.

While income poverty would appear to be an easy concept, compared to more multidimensional measures of poverty, different ways of measuring give rather different results. In Peru, for example, international poverty estimates based on the one dollar per day criterion would yield an incidence of extreme poverty of 15 per cent of the total population. National estimates of income poverty based on a slightly different methodology elaborated by UNDP¹ raises the incidence of extreme poverty in Peru to 23.5 per cent. In Brazil, to take another example, the differences are also striking: World Bank estimates based on one ppp dollar per day give an astonishingly low figure of extreme poverty: five per cent. The UNDP estimates indicate an incidence of almost 14 per cent, i.e. almost three times higher.

¹ See UNDP's website www.undp.org/rblac/targets for a presentation of methodology and results for a large number of Latin American countries.

The Economic Commission for Latin America and the Caribbean (ECLAC) normally presents higher estimates of the incidence of poverty than the World Bank and UNDP. According to recent data from ECLAC,² 43.8 per cent of the population of Latin America and the Caribbean, about 211 million people, are classified as “poor”, while 19 per cent (89 million) are extremely poor.

All income-expenditure based measures of poverty fail to take the availability and quality of vital social services into account. It is therefore quite possible for public services to deteriorate without this being reflected in current income poverty assessments. Or, as expressed by Ravi Kanbur:

“If the bus service that takes a woman from her village to her sister’s village is cancelled, it will not show up in these measures. If the health post in the slum runs out of drugs, it will not show up. If the primary school textbooks disappear, or if the teacher does not turn up to teach, it will not show up.” (Kanbur 2000, p. 7).

This is not the place to discuss statistical and methodological issues related to poverty measures. The point to be stressed is, however, that in addition to familiar problems surrounding data collection based on household surveys there are a large number of complications related to what the different poverty measures really capture.

When international comparisons are being made, the difficulties are compounded.

In short: *all* figures related to poverty measures should be treated with great caution. Data originating from different sources using different methodologies should never be used for comparisons over time, or between different countries. For this and other reasons, the discussion in this paper will be of a largely qualitative nature, with emphasis on causes of poverty in South America and of possibilities, obstacles and constraints related to poverty reduction.

I will, however, begin with a few figures indicating some salient facts and trends.

Poverty in South America: Incidence and Recent Trends

Beginning with the simplest indicator of extreme poverty, the number of people living on less than one USD a day, the development in Latin America and the Caribbean between 1987 and 1998, based on World Bank estimates, is illustrated in Table 1 below:

Table 1. Income poverty in the LAC region 1987 and 1998. People living on less than one ppp dollar a day. Millions and percent of total population. Rounded figures

	1987	1998
Number of people (millions)	64	78
Share of total population (%)	15.3	15.6

Source: World Bank, *World Development Report (WDR) 2000/2001*, p. 23.

If we turn our attention to the situation in different South American countries, the estimated prevalence of extreme poverty is illustrated in Table 2.

² For a brief discussion, see Valenzuela (2002).

Table 2. Share of population living below one ppp dollar a day in major South American countries. Situation in the mid-late 1990s (data from different countries refer to different years).

Percent of population	
Argentina	below 2 %
Bolivia	11 %
Brazil	5 %
Chile	4 %
Colombia	11 %
Ecuador	20 %
Paraguay	19 %
Peru	16 %
Uruguay	below 2 %
Venezuela	15 %

Source: World Bank, WDR 2000/2001

As indicated above, the World Bank figures appear very low, compared to other estimates. And in several countries – including, of course, Argentina – the situation today is appreciably worse than in the late 1990s.

In the last few years, characterised by zero or negative income growth in the South American region, poverty has actually increased in a majority of countries. Available statistics on economic stagnation and rising unemployment are also confirmed by the fact that the population's perception of the situation indicates a serious deterioration. For example, according to a Latinobarómetro public opinion survey of 17 Latin American countries³,

- two of three Latin Americans believe that economic conditions are bad or very bad, and the proportion of those who characterise the situation as bad or very bad has increased in 14 of the 17 countries;
- three of four Latin Americans think that poverty has increased in the past five years; and
- only one in four believes that the economy will improve in the near future.

Human Development Indicators

Contrary to various measures of poverty, which usually indicate that the incidence of poverty is more or less of the same magnitude today as twenty years ago, the Human Development Index (HDI) developed by UNDP (United Nations Development Programme), reveals a continued improvement in the LAC region. While the improvements registered were appreciably greater in the 1960s and 1970s, the overall trend has continued to be positive:

³ A brief summary of the most recent survey is found in Inter-American Development Bank, *Latin American Economic Policies*, Vol. 17, First Quarter 2002.

Table 3. HDI values 1960–99. Latin America and the Caribbean.

1960	1970	1980	1992	1999
0.467	0.568	0.682	0.757	0.760

Source and methodology: UNDP, *Human Development Report (HDR)* 1994 and 2001.

If we look at HDI values for individual South American countries, and compare various social indicators, we get the following picture:

Table 4. HDI values (1999) and key social indicators (1999 or 2000) in major South American countries

	HDI at birth (years) (per 1,000)	Life expectancy mortality rate	illiteracy rate (%)	Under-5	Adult
Argentina	0.842	74		22	3
Bolivia	0.648	62		83	15
Brazil	0.750	67		40	15
Chile	0.825	76		12	4
Colombia	0.765	70		28	9
Ecuador	0.726	69		35	9
Paraguay	0.738	70		27	7
Peru	0.743	69		48	10
Uruguay	0.828	74		17	2
Venezuela	0.765	73		23	8

Source: UNDP, *HDR 2001* (HDI values), Table 1, and World Bank, *WDR 2002* (other indicators), Table 1.

Who are Poorest?

While urban poverty has been increasing rapidly in a majority of South American countries, poverty is still appreciably more widespread in rural areas. In addition to suffering from income poverty, the rural population is severely discriminated against as regards access to clean water and sanitation and social services such as health and education.⁴

Indigenous people, especially in rural areas, are strongly overrepresented among South America's poor. The figures and percentages for indigenous poverty are several points higher than for non-indigenous poverty; in the most extreme cases, such as Peru and Bolivia, this difference can be in excess of 20 percentage points (see table 5).

Table 5. Indigenous poverty in Peru and Bolivia (percentage of the population below the poverty line)

Country	Indigenous	Non-indigenous
Bolivia	64 %	48 %
Peru	79 %	50 %

Source: ECLAC, *Equity, Development and Citizenship* (2000), p. 335.

⁴ A wealth of data concerning urban-rural differences in income and access to social services is presented in IFAD (2001).

The typical poor is a woman or a child – not an adult man.

Estimates indicate that the income earned by a woman typically ranges between one-third and two-thirds of the income earned by a man.⁵ While too little is known about the intrahousehold distribution of consumption, it is clear that women, on average, are much poorer than men.

The pronounced gender inequality in Latin America is not only bad in itself – it is also bad for economic growth and poverty reduction. Numerous studies demonstrate convincingly that improving girls' and women's access to education, credit and productive resources has a very positive impact on economic growth.

Child poverty is also higher than adult poverty. The reason is that poor families tend to have more children than non-poor families, and also that families with a large number of children usually face more problems than others in escaping the poverty trap. It is estimated that more than four out of ten children under the age of nine in the LAC region – some 43 million children – live on less than two USD/day.⁶ The number of children and adolescents (under 20) living in poverty has, according to a recent report from ECLAC, increased from 110 million in 1990 to 114 million in 1999.⁷

In view of the importance of investing in children in all effective poverty reduction strategies, we will return to the issue of child poverty several times in this report.

Cyclical and Permanent Poverty

“Cyclical”, or transient, poverty occurs during economic downturns – for example as witnessed in a majority of South American countries in the wake of the debt crisis of the 1980s – when employment opportunities and real wages experience a sudden deterioration. A large number of households may thereby fall below the poverty line. If the victims of negative shocks have skills and connections that enable them to come back to the labour market the long-term impact is often limited, however.

In view of the high volatility of growth and employment in South America (see further chapter 2 below), rapid increases in poverty resulting from macroeconomic shocks of various kinds are more frequent in this region than in countries with a more stable macroeconomic environment, and with appropriate institutions in place capable of managing external shocks.

A more serious form of poverty is what may be called permanent, or entrenched, poverty, which can be interpreted as a lack of resources and capabilities to support a family even when overall economic conditions are normal. When entrenched poverty is widespread, an exceptionally strong economic and social environment is needed to pull significant numbers of disadvantaged individuals out of poverty, and poverty is much more likely to be transmitted to the next generation or generations.

Cyclical poverty may have a permanent impact on the affected families. If a sudden crisis results in children suffering from malnutrition or being taken out of school, or in domestic violence or family disruption, cyclically poor children are at risk of becoming functionally poor, with long-lasting handicaps for themselves and their children.

⁵ For data, see UNDP, *HDR 2001*, Table 21.

⁶ Inter-American Development Bank, *Breaking the Poverty Cycle: Investing in Early Childhood* (1999).

⁷ ECLAC press release dated 15 November 2001. The full text of the study referred to is available at ECLAC's web site www.eclac.cl

The deeper and longer the crisis, the greater the danger that poverty becomes entrenched. The fact that poverty failed to decrease in a majority of South American countries during the economic recovery in the 1990s indicates that the profound economic crisis of the 1980s did convert part of the cyclical poverty into persistent, or entrenched, poverty.

Poverty Reduction Begins with Children

The intergenerational transmission of poverty is the process by which parents living in poverty transmit their poverty and disadvantage to their children. It is a powerful force behind the perpetuation of poverty and inequality in the Latin American countries.

The single most important factor that contributes to the persistence of poverty is the low level of education of the children of the poor. The strong presence of the intergenerational transmission of poverty is witnessed by the fact that children from poor families, on average, tend to have several years less of schooling than children from non-poor families. An analysis of data from 16 Latin American countries indicates that only 26 per cent of children born poor complete secondary education, as against 63 per cent of all children born in non-poor families. Or, formulated in another way: the probability that a child born in a non-poor household completes secondary school ranges between one and a half times and five times that of a child born in a poor household, depending on the country.⁸

The education of the mothers, in particular, is critical in determining the education of their children. Studies from various countries indicate that each additional year of formal education completed by a mother raises her children's educational attainment by an additional one-third to one-half year (see Castañeda and Aldaz-Carroll, 1999).

Economic Growth and Poverty Reduction: a Dual Relationship

Growth is Good for Poverty Reduction

The development of income poverty depends on two, and only two, variables: income growth and income distribution.

As regards growth, the close correlation between economic growth and poverty reduction is a well-established fact. By and large, the absolute number of people living in poverty has dropped in all countries that have sustained rapid economic growth for a significant number of years.

One can, of course, imagine a situation in which only the better-off households benefit from growth. This requires, however, that income disparities widen continuously. In a longer term perspective, this is rather unlikely to happen. Or, as observed by Dani Rodrik: "*Income distribution tends to be stable over time, and rarely changes so much that the poor would experience an absolute decline in incomes while average incomes grow in a sustained fashion.*" (Rodrik 2001, p. 12)

In a majority of South American countries income distribution is extremely unequal, in an international comparison, but comparatively stable. A slight tendency to deterioration, i.e. widening income differences, has, however, been observed in the continent as a whole (see chapter 3 below). Unless this tendency is further accentuated, we can assume that higher economic growth is good for poverty reduction.

⁸ See Aldaz-Carroll and Morán (1999), p. 43.

Naturally, a combination of high growth and reduced inequality yields the best results. To illustrate how sensitive poverty reduction is to changes in income distribution, we could use the results of a simulation exercise made by UNDP⁹ showing what the achievement of the Millennium Goal of reducing extreme poverty by one-half in Brazil by 2015 would require. Taking the ECLAC estimate of an incidence of extreme poverty of 13.84 per cent of the population in 1999 as the point of departure, to reduce by half this share would require either

- an annual rate of growth of per capita income of 2.9 per cent between 2000 and 2015 if today's inequality, measured by the Gini coefficient, remains unchanged; or
- an annual rate of growth of per capita income of only 0.5 per cent during the same period if a rather modest reduction of 2.5 per cent of the Gini coefficient could be achieved.

What this simple illustration shows is that without improvements in income distribution, the attainment of the Millennium Goal of a fifty per cent reduction of extreme poverty will be exceedingly difficult to reach; it would require rates of economic growth far higher than those registered in South America during the past decades.

Poverty Reduction is Good for Growth

While growth is good for poverty reduction, poverty reduction is also good for economic growth. Policies that increase the incomes of the poor, such as enhanced employment opportunities for low-skilled workers, investments in primary education, health and nutrition, water and sanitation in poverty-stricken areas, rural infrastructure, etc. improve the productive capacity of the whole economy and raises domestic demand for basic goods and services.

A large number of studies¹⁰ show that in a majority of developing countries, investments in agriculture and in rural physical and social infrastructure serving the rural poor tend to have a much larger effect on poverty reduction than investments in urban areas.

Also, policies which reduce poverty and unemployment are likely to enhance social cohesion and reduce problems related to social exclusion, crime and violence which, in addition to lowering the overall quality of life, also have strongly negative repercussions on the entire environment for productive investment and economic growth.

Actual developments as regards economic growth and income distribution, and some of the reasons for the limited success registered in both these respects, will be discussed in subsequent chapters. Suffice it here to stress that any poverty reduction strategy worth its name must simultaneously address South America's twin dilemma: low and unstable growth and unequal distribution.

⁹ See Ferreria & Leite (2002).

¹⁰ For an overview of available empirical evidence, see Mellor (1999). The key role of developing infrastructure and market-supporting institutions in rural areas is also stressed in IFAD (2001).

Chapter 2. Economic Growth: Achievements and Constraints

This chapter is a brief overview of South America’s development in recent decades in terms of economic growth, savings and investment and participation in world trade. To highlight some of the major reasons for the continent’s disappointing performance, comparisons are frequently made with developing countries in Asia, where economic achievements have tended to be far superior to those of South America.

Since much of the data published by institutions like the World Bank, ECLAC and UNDP refers to Latin America and the Caribbean rather than to South America this chapter relies, like the rest of the paper, to a large extent on statistics covering the entire LAC region.

Growth of Income and Production

Today’s average income in South America is only marginally higher than twenty years ago.

The 1980s, characterised by the debt crisis and by macroeconomic chaos, was a “lost decade”, with a low or negative growth of per capita income and a concomitant increase in poverty in virtually all countries. While the situation stabilised in the 1990s, the rate of economic growth was still low, compared to the situation in the 1960s and 1970s, and highly volatile.

The growth performance between 1960 and 1998 is illustrated in table 6:

Table 6. Annual growth of GNP per capita in the LAC region 1960–1998.

1960–69	1970–79	1980–89	1990–98	1960–79	1980–98
2.7%	3.3%	-1.1%	1.9%	3.0%	0.2%

Source: Based on World Bank, *World Development Indicators*, 2000 cd-rom.

The economic reforms carried out in a majority of countries after the debt crisis – usually, but not always, in connection with structural adjustment programmes supported by the International Financial Institutions (IFIs) – were successful in stabilising a number of macroeconomic variables. Inflation went down drastically in the 1990s, compared to the turbulent 1980s, and fiscal deficits were gradually being reduced to rather low levels. Trade and exchange rate reforms helped to encourage exports. Still, the basic expectation which underpinned the so-called *Washington consensus* – that the combination of a more open economy and stable macroeconomics would by itself spur economic growth – has not been borne out.

Little progress in terms of growth of productive investment and employment has been registered. In most respects, the economic and social development during the decades preceding the economic reform programmes was appreciably better than in the 1980s and 1990s.¹¹

In only one South American country – Chile – was the rate of economic growth higher between 1980 and 2000 than between 1960 and 1980.

¹¹ The apparently favourable development in the 1970s – stimulated by, among other things, high commodity prices and easy access to foreign credit at low rates of interest - can not, however, be used to support the argument that the policies pursued during this period were good and sustainable. They were not, by and large – the macroeconomic collapse in the 1980s was primarily the result of irresponsible and unsustainable policies carried out earlier.

There are, however, large differences in growth performance between the different countries. Table 7 shows the average rate of growth between 1960 and 2000 for the major South American countries.

Table 7. Average annual rate of growth (in per cent) of GDP in major South American countries 1960–2000

	1960–70	1970–80	1980–91	1992–2000
Argentina	4.2	2.2	-0.4	3.5
Bolivia	5.2	4.8	0.3	3.4
Brazil	5.4	8.4	2.5	2.9
Chile	4.5	2.4	3.6	7.2
Colombia	5.1	5.9	3.7	2.8
Ecuador	--	8.8	2.1	1.7
Paraguay	4.2	8.6	2.7	2.2
Peru	4.9	3.0	-0.4	4.1
Uruguay	1.2	3.5	0.6	3.3
Venezuela	6.0	5.0	1.5	1.3
Unweighted Average	4.5	5.3	1.6	3.2

Source: World Bank, *WDR 1982* (1960–80), *WDR 1993* (1980–91) and IMF, *World Economic Outlook*, October 2000 and October 2001 (1992–2000).

More recent statistics, from 2001 and 2002, indicate that growth is appreciably lower today than in the late 1990s. The largest economy, Brazil, registered a slightly negative growth of per capita income in 2001, and virtually all South American economies presently find themselves in the midst of a deep crisis (Argentina) or a severe or moderate recession. The Inter-American Development Bank may not be exaggerating when it bluntly states: “Latin America is suffering its worst crisis in decades.”¹²

The effects of the decline in average growth rates registered during the past two decades have been compounded by a pronounced increase in macroeconomic volatility and income insecurity.¹³ Table 8 gives one illustration of this phenomenon:

Table 8. Economic insecurity as expressed by the probability (in per cent) that per capita income will fall by five per cent in one single year.

	1960s	1970s	1980s	1990s
Argentina	7.9	5.4	36.5	3.3
Brazil	2.3	0.2	12.4	14.4
Chile	0.4	25.5	17.5	0.0
Colombia	0.0	0.0	0.5	0.0
Peru	3.5	3.6	36.5	17.8
Uruguay	4.3	0.3	28.7	0.4
Venezuela	5.4	1.5	37.3	9.0

Source: Rodrik (1999a), Table 6B.

¹² *Latin American Economic Policies*, Vol. 17, First Quarter 2002, p. 1.

¹³ For data, see, for example, Rodrik (1999a), from which part of the discussion in these paragraphs is taken.

The causes of high instability – which is reflected in many different macroeconomic variables such as GDP, investment, capital flows, employment and foreign trade – are related to both external shocks and domestic policy failures. On the external front, instability in private capital flows is by far the largest contributor, but positive and negative terms of trade shocks have also played an important role in many countries.

On the domestic policy front, collapsing pegged exchange rates, erratic monetary policies and frequent shifts in economic policies – and a high rate of turnover of key economic policy-makers – are largely responsible for the sometimes rather dramatic downturns that have been registered in virtually all countries (except Chile, where economic growth has been both high and quite stable since the mid-1980s, and Colombia).

The effects of macro instability on income distribution and poverty, and the mechanisms through which macro shocks are transmitted to enhanced vulnerability at the household level, will be further discussed in the next chapter. Suffice it here to stress that the typical Latin American “boom-bust” cycles have continued to characterise the overall economic performance. And, not least important: most countries have been unable to develop adequate political and social institutions capable of handling external shocks and distributional conflicts.

This is the perhaps biggest challenge for the future. A country’s institutional capacity to deal with shocks is today increasingly recognised as a key element in all “success stories”.¹⁴

Savings and Investment

One obvious reason for the relative stagnation of Latin America compared with the most successful East Asian countries is the relatively low level of domestic savings and investment.

Table 9 below illustrates how savings and investment have developed since 1987. A comparison is made between the LAC region and four newly industrialising (NIC) Asian countries (Hong Kong, Taiwan, South Korea and Singapore) and with the rest of East and South Asian countries (“developing Asia”).

Table 9. Savings and investment in Latin America and the Caribbean and Asia 1987–2000.

Region	Savings as % of GDP		Investment as % of GDP	
	1987-94	1995-2000	1987-94	1995-2000
LAC	19.3%	18.4%	21.2%	21.3%
Asian NICs	35.1%	32.3%	30.8%	29.1%
Developing Asia	29.7%	32.0%	30.7%	31.2%

Source: Based on IMF, *World Economic Outlook*, May 2001.

As seen above, domestic savings remain stagnant in Latin America, and the distance to the thrifty Asian nations is very large.

¹⁴ For interesting discussions see, for example, Rodrik (1999a and 1999b and 2001), Nora Lustig (1999) and Ffrench-Davis (2001).

The gap in Latin America of two-three percentage points of GDP between domestic savings and investment represents the current account deficit, largely covered by private capital inflows, and may not be sustainable.

With the region's low – and, at present, falling – levels of investment, growth of per capita income will remain too low to reach the Millennium goal of poverty reduction in a majority of South American countries.

Trade Performance

After the second World War, Latin America's share of world trade was quite respectable: over twelve per cent. In 1960 it was down to 7.7 per cent. Today, Latin America accounts for slightly less than four per cent of total exports of goods and services in the world.

A comparison with developing countries in Asia could, again, be useful to illustrate the marginalisation of Latin America in the world economy.

Table 10. Exports of goods and services from Latin America and Asia (excluding Japan and the Middle East) 1970, 1980, 1990 and 1998. Billions of current USD

	1970	1980	1990	1999
LAC	19	125	169	336
Developing Asia	14	124	274	685
LAC as per cent of Asia	136%	101%	62%	49%

Source: Based on World Bank, *WDR*, various issues. If Mexico - whose trade performance has been superior to that of South America in recent decades - is excluded, the gap vis-a-vis Asia widens further.

While the data presented in Table 10 above clearly illustrates the gradual deterioration in the Latin American economies' international competitiveness compared to the successful Asian countries, it must be acknowledged that the 1990s witnessed a quite respectable growth of the region's exports – far higher than the sluggish growth of trade in the 1980s (but inferior to the development in the 1970s). What is most striking is perhaps the fact that the rather dynamic trade sector failed to have a strong positive impact on the overall growth of income and employment.

One explanation of the lack of capacity of exports to act as an “engine of growth” is the slow progress made by the South American economies in upgrading their comparative advantages and move into more skill-intensive exports.

Again, a comparison with some of the successful Asian countries could serve to indicate how Latin America is lagging behind. For example, while over 66 per cent of South Korea's exports are classified as “high and medium-technology exports”, the corresponding figures for South American countries are far lower, for example Argentina 19 per cent, Colombia 14 per cent, Chile 6 per cent and Peru 3 per cent.¹⁵

If we compare the composition of exports for two countries, Chile and Malaysia, which have approximately the same per capita income (in ppp terms), we can see that Malaysia, like Chile traditionally a mineral exporter, has carried out a very successful export diversification away from

¹⁵ UNDP, *Human Development Report 2001*, Table A:2.1

its natural endowment while Chile - the great "success story" of South America - has remained highly dependent upon primary commodities:

Table 11. Structure of merchandise exports. Chile and Malaysia 1970 and 1993. Percentage shares of total export value.

	1970	1993
Primary commodities		
Chile	95	81
Malaysia	93	35
Machinery and Transport Equipment		
Chile	1	3
Malaysia	2	41
Other Manufactures (excl. textiles)		
Chile	4	16
Malaysia	6	24

Source: Based on World Bank, **WDR 1995**, Table 15.

The External Sector: Muddling through, or a New Debt Crisis in Sight?

As seen earlier, export development – supported more by competitive exchange rates than by export diversification and concerted attempts to export promotion – was acceptable, though far from spectacular, in the 1990s. But current account deficits remain high in a number of countries, and great uncertainty surrounds the future direction of the highly volatile private capital flows. “Contagion” from the crisis in Argentina, and a general lowering of confidence in Latin America among private investors, is likely to reduce the inflow of private capital to the region during the next couple of years and to make new borrowing more expensive.

The problem with capital flight, endemic in the region, has become aggravated in countries like Argentina and Venezuela, and political uncertainty in many other countries (Ecuador, Colombia, Paraguay and others, plus increasing pre-election nervousness in Brazil) may, in a worst-case scenario, give rise to a new wave of large-scale capital flight.

Leaving these speculations aside, let us have a brief look at the region’s foreign debt situation. Manageable or not?

Table 12. External debt in major South American economies. Billions of USD and as percentage of annual exports of goods and services.

	Total external Debt as per			Debtcent of exports		
	1980	1990	1999	1980	1990	1999
Argentina	27	62	148	242	412	563
Bolivia	2.7	4.3	6.2	258	429	509
Brazil	71	116	245	305	321	444
Chile	12	19	38	193	180	209
Colombia	6.9	17	35	117	181	259
Ecuador	6.0	12	15	202	370	298
Paraguay	1.0	2.1	2.5	122	107	295
Peru	9.4	20	32	194	485	462
Uruguay	1.7	4.3	7.4	104	181	314
Venezuela	29	33	36	132	155	109
Total	167	290	565	187*	282*	346*

* Unweighted average

Source: 1980 and 1990: based on World Bank, *World Debt Tables 1993–94*, Volume 2. 1999: based on World Bank, *WDR 2002*. The figures presented in Table 12 are likely to represent a considerable underestimate, however, as a number of private transactions involving external indebtedness tend to be missing in official data. For a discussion, see Latin American Newsletters, *Special Report*, April 2002.

As can be seen above, virtually all countries have seen their foreign debt in relation to exports increase dramatically all through the 1980s and 1990s. In relation to GDP, the increase in foreign debt has been even more pronounced (as exports have increased faster than GDP).

As regards the composition of the debt, there have been considerable changes over the period 1980–2000. In the early 1980s, the region’s foreign debt was dominated by commercial bank loans to governments. The share of such debt has gradually been reduced, while other private capital flows – such as foreign loans to South American private banks and enterprises and, in particular, foreign purchases of government bonds – have increased, as has the share of debt to multilateral financial institutions (primarily the World Bank, the Inter-American Development Bank and the IMF).

This is not the place to analyse the South American debt problems in detail. Each country has its own, specific situation, and the terms of the debt – interest rates, maturity, existence of explicit or implicit public guarantees of private sector debt, etc. – vary tremendously. A few general observations can however be made:

- Despite almost twenty years of efforts to deal with the Latin American “debt crisis” the situation is today, in key respects, even more serious than ten or twenty years ago.
- For reasons indicated earlier, prospects for a considerable net inflow of private capital to South America are appreciably worse today than a couple of years ago.

- The highly volatile nature of private capital flows makes the situation exceedingly precarious in a number of countries, in particular in view of the fact that virtually all countries have abolished currency regulations and capital controls.
- “Contagion” from the Argentine crisis, coupled with a generalised perception of increased risk among foreign investors, is making new external borrowing more expensive in the entire LAC region.
- The only South American country to qualify for the HIPC initiative, Bolivia, is likely to see its debt burden substantially reduced in a short to medium-term perspective. A likely outcome is, however, that the debt relief granted will be used – following Bolivia’s past experience as well as the usual pattern in poor and highly indebted countries which have been granted debt relief – to indulge in massive new borrowing.
- The "rules of the game" have encouraged excessive borrowing. Problems of moral hazard, arising when private creditors take excessive risks in the belief that they are protected by an implicit guarantee by the debtor country government and by the international financial community, have been accentuated by the international rescue packages in a number of emerging economies that have been affected by serious financial crises in the past ten years: Mexico, Brazil, Russia, South-East Asia, Turkey and many others.¹⁶ The major exception is Argentina which, for a number of reasons¹⁷, has been left out in the cold.

The precedent set in Argentina is likely to reduce the problem with moral hazard, but in a short-term perspective, it signals that both creditors and debtors will have to assume higher risks in case of defaults. This is likely to further discourage capital flows to the region.

To summarise: the external debt is again becoming a serious threat to South America’s economic recovery and future growth prospects.

Education and Human Capital

To invest in people is not only good in itself – it is also good for economic growth. A number of studies have convincingly confirmed that human capital is the key to sustained development. In an increasingly knowledge-based globalised economy, education becomes more and more important. Research suggests that increasing the labour force’s average education by one year may raise GDP by nine per cent.¹⁸

Perhaps even more important, from the point of view of poverty reduction, is the fact that each individual’s possibilities to escape poverty are strongly related to his or her education. According to a study made by the ECLAC¹⁹, the minimum formal schooling required in the LAC region in order to have a 90 per cent chance of not falling into, or continuing in, poverty now exceeds ten years. The regional average of school years is appreciably below that figure (see below).

¹⁶ The problem of moral hazard in connection with financial crises in Latin America and elsewhere is discussed at length in de Vylder (1999).

¹⁷ The Bush administration has repeatedly emphasised that it is far less inclined than Bill Clinton to use the IMF, the World Bank and the U.S. government to bail out countries in trouble. Especially countries where U.S. financial interests are not so heavily involved; in Argentina, the biggest losses are likely to affect European and Latin American bond holders and creditors. Argentina’s geopolitical situation – far away from al-Qaeda and the oil-rich Middle East – may also explain why for example Turkey, after its recent financial crisis, has received a far more benevolent treatment than Argentina.

¹⁸ For a survey of evidence, see UNDP, *HDR* 1996.

¹⁹ See ECLAC, *Education and Employment. The Two Master Keys to Development* (2000)

Between 1950 and 1980, South America witnessed a dramatic expansion of its educational systems, although the pace varied from country to country. There was a pronounced reduction of illiteracy, and a spectacular increase in the coverage of primary education. Secondary and tertiary education were also expanded rapidly.

By and large, educational standards have continued to improve in South America in recent decades, notwithstanding the serious economic crisis affecting most of the region in the 1980s. Virtually all indicators related to health and nutrition standards also show that progress in human capital formation has continued in most countries during the past two decades, albeit not as solidly as in the 1960s and 1970s.

Still, educational achievements are considerably below what could be expected given the region's average income level. While initial enrolment is high – in most countries, virtually all children do begin primary school – repetition rates are high, and over one-third of all pupils drop out before finishing primary school.

The “knowledge gap” vis-a-vis the OECD countries and the newly industrialising countries in East Asia is not narrowing – rather the contrary. According to estimates made by the Inter-American Development Bank (1997), Latin America's educational performance was comparable to that of East Asia in the 1970s. Today, the average Latin American adult has around six years of schooling, and the average East Asian counterpart seven to eight (in South Korea almost eleven).

Table 13 illustrates the development of schooling ratios at secondary and higher levels between 1985 and 1995.

Table 13. Enrollment rates in secondary and tertiary education in Latin America and a group of Asian countries.

Groups of countries	Net enrollment ratios			
	Secondary		tertiary	
	1985	1995	1985	1995
Latin America and the Caribbean	50.2	56.6	15.8	17.3
Recently industrialised Asian countries*	57.3	71.3	14.8	24.0

* Hong Kong, South Korea, Singapore, China, Malaysia and Thailand.

Source: ECLAC, *Equity, Development and Citizenship* (2000) p. 113.

In addition, the highly unequal access to schooling in Latin America, compared with East Asia, perpetuates Latin America's pervasive social inequality.

The single most important factor that contributes to the persistence of poverty is the low level of education of the children of the poor. As emphasised earlier (see chapter 1), children from poor families, on average, tend to have several years less of schooling than children from non-poor families.

By all criteria, East Asia's educational systems are both better and more egalitarian than Latin America's. The quality of education also differs; the quality gap, to Latin America's disadvantage,

is reflected in the fact that students with the same number of school years behind know less if they have gone to a school in Latin America than if they have received their education in East Asia.²⁰ Virtually all comparative tests on school children's educational performance in subject matters such as mathematics, reading and technical skills, etc. reveal that the East Asian children are doing far better than their Latin American peers (and, quite often, better than students from the United States and Western Europe as well).

In higher education, the differences widen further. To take one example: At present, South Korea produces more civil engineers per 100,000 inhabitants than Western Europe, on average. South America does not. In Korea, there were, in the mid 1990s, 2.3 research and development scientists and technicians per 100,000 people – in Chile, only 0.6, in Venezuela 0.2 and in Colombia 0.1 (source: UNDP, *HDR 1996*, Table 14).

Crime and Violence

A number of recent studies²¹ have demonstrated the high incidence of crime and violence in Latin America. Table 14 below illustrates two forms of crime: major robbery and homicide.

Table 14. Crime rates by region, 1985–95 (number of crimes per 100,000 inhabitants, regional means, rounded figures)

Region	Number of Countries	Major robberies	Intentional homicide
Africa	8	36	5
Asia	10	13	5
LAC	17	201	14
Eastern Europe and Central Asia	15	28	7
Western Europe	16	54	4
United States	1	249	7

Source: Bourguignon (1999, p. 201)

The average for Latin America and the Caribbean is, as seen above, extremely high, by international standards. And while the crime rate has been going down in the United States for a number of years, it has been increasing continuously in most South American countries.

The disparities between the individual South American countries are very high. For example, while Chile reports fewer than 5 homicides per 100,000 people and year, Venezuela has 14 and Brazil 20. Colombia registers a staggering 66 homicides per 100,000 inhabitants.

Major cities are less safe than rural areas. For example, in 1995, the homicide rate was estimated to be 80 per 100,000 in Rio de Janeiro and 52 in Caracas, compared with national averages of 20 and 14.

There are, of course, a number of different reasons for the unusually high crime rate in several South American countries. A tradition of political violence and civil strife, as in Colombia, is one

²⁰ For an overview of education in Latin America compared to other developing regions see, for example, *The Economist*, May 11th, 2002.

²¹ See, for example, Londoño and Guerrero (1999), Bourguignon (1999) and Holmqvist (2000) and the references found therein.

obvious contributor. Trade in drugs is another. Various studies (see, for example, Bourguignon, 1999, or Holmqvist, 2000) also identify inequality – extremely high in Latin America – as a major explanatory factor. A weak social capital also emerges as an important factor behind crime and violence.

The high crime rate contributes to the widespread feelings of insecurity felt by many people, as reported by various opinion polls from South American countries. It also acts as a deterrent to investment, including foreign investment, and contributes to the brain drain of professionals.

The economic and social costs of crime are difficult to estimate, but the attempts made (see Londoño and Guerrero, 1999, and Bourguignon, 1999) indicate that they are considerable. Bourguignon (p. 215) summarises some of the findings in the following way:

“Summing all these components leads to a social cost of crime equal to 3.8 per cent of GDP in the United States and a stunning 7.5 per cent in Latin America. Although both figures are rough, their order of magnitude is probably about right. As noted, by world standards the countries covered by this analysis have very high crime rates. In most European and Asian countries the same calculation would likely result in figures below 2 per cent of GDP.”

We have to conclude that unless the mounting problems of crime and violence are properly addressed, the worst affected South American countries will not be able to reach the Millennium Development Goals. And this leads us over to the question of inequality, which appears to be at the root of a number of serious constraints to sustainable social, economic and human development in the region.

Chapter 3. Income Distribution and the Role of Social Spending and Security Nets in Poverty Reduction

The main purpose of this chapter is to discuss income distribution in South America. Apart from presenting some salient figures and trends, the chapter pays special attention to issues of economic insecurity and vulnerability to shocks. The second part of the chapter is a discussion of how public interventions in areas such as social sector development and safety nets could be improved in order to reach the goal of poverty reduction.

To begin with, a few data could illustrate income inequality in different countries:

Table 15. Inequality in income or consumption in major South American countries and selected countries from other regions.

	Year	Inequality measure	
		Richest 20 % to poorest 20 %	Gini coefficient
Bolivia	1997	32.0	58.9
Paraguay	1998	31.8	57.7
Brazil	1997	24.4	59.1
Colombia	1996	20.3	57.1
Chile	1996	18.2	57.5
Venezuela	1997	13.0	48.8
Peru	1996	11.7	46.2
Ecuador	1995	9.2	43.7
Uruguay	1989	8.9	42.3
Argentina *			
South Africa	1993-94	22.6	59.3
Zambia	1998	17.3	52.6
Mexico	1996	14.3	51.9
Costa Rica	1997	11.5	45.9
United States	1997	9.0	40.8
Thailand	1998	7.6	41.4
India	1997	5.7	37.8
Vietnam	1998	5.6	36.1
South Korea	1993	5.3	31.6
Bangladesh	1995-96	4.9	33.6
Sweden	1992	3.6	25.0
Denmark	1992	3.6	24.7

* Data lacking.

Source: UNDP, *HDR 2001*, Table 12.

The data presented above may be inaccurate in many respects – statistics on income distribution are seldom very reliable – but however measured, Latin America always stands out as the region with the highest income differences in the world. Only a few African countries can match Latin America's inequality. At the other end of the scale, i.e. countries characterised by relatively low inequality, we find the small Scandinavian nations and a number of countries in Asia.

When incomes are very unevenly distributed, a country's average per capita income becomes rather irrelevant as far as the poor are concerned. For example, in Brazil the poorest 20 per cent of the population have an average income which is lower than that of their counterparts in one of the poorest countries in the world, Bangladesh:

Table 16. Per capita income of the poorest 20 per cent of the population in 1993 (ppp dollars).

Country	Average per capita Income	Per capita income of the poorest 20 %
South Korea	9,630	3,563
Chile	8,400	1,386
Bangladesh	1,290	613
Brazil	5,370	564

Source: Basu (1995).

The highly uneven distribution of income in South America is also accompanied – and reinforced – by inequality in other respects: political influence, social status, access to education, etc.

Social movements and institutions genuinely representing the poor are, by and large, weak and fragmented.

The task of transforming the South American countries into more egalitarian societies is therefore daunting, and goes far beyond economic policy-making in a narrow sense.

It falls beyond the scope of this paper to attempt an analysis of the historical origins of the striking inequality in Latin America. Suffice it here to stress that factors dating back to colonial times – such as the extremely unequal distribution of land and political power established by the Spanish and Portuguese colonial powers and their settlers – are important, and that the class structure established many hundred years ago has been amazingly resilient to change.

The Cyclical Behaviour of Income Distribution

In recent times, various studies reveal a relatively stable distribution, albeit with a slight tendency towards deterioration. Or, to quote a summary analysis by ECLAC, based on a large number of studies:

*“Changes in income distribution...show no sustained tendency to improve. In fact, although comparing data on income distribution over long periods of time is a complex matter, there may be no country in the region where inequalities are lower than they were three decades ago (when measuring instruments were already in place in a number of countries), and in many countries the inequality is far greater today...Among the Latin American countries, Uruguay is perhaps the only one where falling levels of poverty are accompanied by a relatively equitable distribution of income in comparison with international patterns, but even there the distribution has not yet regained the favourable levels that it enjoyed until thirty years ago.” (ECLAC, *Equity, Development and Citizenship*, 2000 p. 67)*

A common pattern appears to be that income distribution deteriorates during crises but that it improves very little during upturns. Thus, while setbacks in terms of unemployment and increased poverty often occur abruptly when the crisis breaks out, recovery tends to be slow and incomplete. One study shows that in 20 episodes of crisis in Latin America during the 1980s and 1990s for

which adequate statistical information is available on the effects on poverty and income distribution, poverty increased in every single case, and inequality was greater at the end of the crisis than before in 15 of the 20 cases (see Lustig, 1999).

During crises, employment and income of the poor are the first victims. Also, the economically poor typically lack political influence and voice to demand the protection of pro-poor programmes and public safety nets in times of fiscal retrenchment. It also appears as if the social groups that benefit from the subsequent upswing may not be the same as those hurt by the crisis, so the losses suffered by the latter become permanent; cyclical poverty becomes entrenched.

Aggregate shocks such as macroeconomic crises also have the effect of weakening traditional safety nets and informal insurance agreements as they typically affect larger groups of people who all become poor.

The social costs of the “boom-bust cycles” which many South American economies have experienced are thereby being accentuated by the pronounced asymmetrical behaviour of social indicators over the business cycle. Unrecoverable loss of human capital also occurs as children leave school never to return, people lose experience, job connections and sometimes even self-esteem when they are being laid off, small-scale entrepreneurs lose their assets and never regain them, etc.

Among the poorest households the effects of even short-term unemployment can be dramatic, as the economic margins are small or non-existent. In addition to the economic loss suffered, unemployment is often followed by family disintegration. The following observations of the effects on family life of the severe unemployment crisis in Chile in the early 1980s may be relevant to what occurs in a large number of countries and families:

“The husband, who used to go out to work, frequently finds himself with no place to go. He loses his identity and his position as the working man whom the woman has to serve and look after when he returns from work. According to women, this results in male aggression, sleeplessness, bad temper, isolation, anguish, and evasion through alcohol.” (Raczynski 1987, pp. 84–85).

What Should Be Stabilised, and Who Should Be Protected?

In view of the high degree of vulnerability to crisis of the poorest households, the problem with the prevailing pattern of high macro volatility in the South American economies must be addressed. A coherent strategy to reduce poverty must begin – but certainly not end - with monetary policies, fiscal policies, exchange rate and trade policies.

For the poorer households, it is stability in employment that matters most. However, employment volatility and insecurity in Latin America have increased dramatically during the past two decades, and employment has become less secure, with the lion’s share of all new jobs having been created in the informal sector of the economy or as temporary jobs not covered by social security. In Latin America as a whole, it is estimated that eight out of ten new jobs created in the formal sector in the 1990s were part-time or temporary (UNRISD 2000, p. 20).

While a poverty-oriented macro policy needs to focus on job creation and stability in production and investment, macroeconomic policy-making in South America in the wake of structural adjustment has concentrated on stabilising other, primarily monetary, variables (inflation, fiscal deficit, etc.). Or, in the words of Joseph E. Stiglitz, referring to structural adjustment programmes in developing countries in general:

“Ironically, macroeconomic stability – as conceived by the Washington Consensus – typically downplays stabilizing output or unemployment. Minimizing or avoiding major economic contractions should be one of the most important goals of policy... The social and economic costs of downturns can be devastating: lives and families are disrupted, poverty increases, living standards decline, and, in the worst cases, social and economic costs translate into political and social turmoil.” (Stiglitz 1998, pp. 14–15).

An interesting comparison between the response to the Great Depression in the United States in the 1930s and the response to the Latin American crisis of the 1980s is provided by Dani Rodrik (1999a, pp. 3 ff.), whom I will quote at some length:

“The United States responded to the Great Depression with a series of major institutional innovations that greatly expanded the role of government in the economy and for the most part represented a sharp break with the past. Many of these innovations took the form of social insurance: social security, unemployment compensation, public works, public ownership, deposit insurance, and legislation favoring unions were among the new mechanisms created to deal with the perceived shortcomings of the private marketplace...”

In Latin America, the upshot of the debt crisis was a series of reforms that actually served to weaken institutions of social insurance... The reforms that Latin America adopted in the 1980s and thereafter were correspondingly aimed at enhancing the scope of the market and reining in that of government. Privatization, deregulation, trade liberalization, and financial liberalization were key items in the Washington Consensus.... What is important from our perspective is the complete absence on the Washington Consensus agenda of prescriptions targeted at economic insecurity.

This is especially striking in view of the fact that many of the market-oriented reforms had the predictable effect of increasing risk for workers and households. Privatization, deregulation, and trade liberalization all entailed restructuring of the economy and greater risk of job loss, at least in the short run. The retrenchment of the public sector meant reduced opportunities for relatively safe public employment. Greater capital mobility implied the shifting of idiosyncratic risk from mobile capital to immobile labor...

We can presume therefore that the economic insecurity generated by the prolonged debt crisis was only amplified by the market-oriented reforms that all countries in the region eventually adopted without instituting complementary programs of social insurance. Whereas the response to the Great Depression in the United States was a significant strengthening of social protection, the response to the debt crisis in Latin America was a weakening of social protection in the face of increased labor-market risk.”

The Need for Countercyclical Policies

The South American economies' increased openness to trade and financial markets opens up many new opportunities, but it also creates dangers of continued instability and recurrent financial crises. Given the high social and economic costs of such crises it is important to pursue macroeconomic policies which mitigate the effects of financial volatility on the real economy, in particular in areas of high social impact such as employment, real wages, poverty and public-sector spending.

The countercyclical components of sound macro policies can assume many different forms, such as attempts to manage short-term capital inflows and to design fiscal targets which concentrate on longer-term sustainability criteria rather than on keeping every single year's budget in balance.

One example of a rather successful experience is Chile in the 1990s, which adopted a battery of different policies aimed towards the surge in capital inflows.²² The basic aim was to make the long-term fundamentals prevail over short-term factors influencing the exchange rate. The measures adopted included, among other things, attempts by the Central Bank – such as the imposition of reserve requirements on portfolio flows and direct interventions in the foreign exchange market – to discourage short-term and speculative capital inflows while maintaining open access to the economy for foreign direct investment (FDI).

Similar, quite successful, methods have been used by several other Latin American countries.

One lesson from recent financial crises, in South America and elsewhere, is that the combination of liberalisation of the capital account, i.e. the removal of all currency restrictions even on portfolio flows, and attempts to peg the exchange rate is a particularly dangerous policy. One can either have free capital movements and floating exchange rates, or fixed exchange rates and currency controls. The extremely vulnerable combination of convertibility on the capital account and a fixed or semi-fixed exchange rate is, however, an open invitation to procyclical currency speculators.

This combination – fixed exchange rates and free capital movements - has over and over again proved unsustainable in Latin America (and in a large number of other “emerging economies”), and is responsible for having aggravated many crises (most recently in Argentina). Fortunately, no South American country applies this exchange rate regime at present, but the experiment with complete dollarisation in Ecuador carries many of the risks associated with a fixed exchange rate (such as loss of international competitiveness if domestic inflation exceeds the international inflation, and subsequent currency collapse).

Other methods to reduce the susceptibility to external shocks may include the establishment of stabilisation funds to manage commodity price fluctuations as implemented by, among others, Chile and Colombia (the Copper Compensation Fund and the Oil Stabilisation Fund, respectively). The idea is to protect the currency reserve – and, by implication, prevent macro developments from becoming excessively pro-cyclical – and to avoid drastic exchange rate fluctuations and volatility in public expenditure and social security.

The concept of stabilisation funds is primarily designed for countries whose exports are dominated by one or two commodities. Its applicability is therefore limited, and even in countries such as Chile and Colombia the record is mixed as far as macro stabilisation is concerned. The policy advice implied by stabilisation funds – “regard every improvement in your terms of trade as transitory” – is, however, of more general relevance. The typical pattern in Latin American economies (and in many other countries as well) is that “good times” often precede the “bad times” – and are equally difficult to handle for stabilisation purposes.

It should also be stressed that the proper handling of macroeconomic shocks is not a “technical” but a highly political question. It is today becoming increasingly recognised that the most successful countries in terms of economic growth – and sustained improvements in social and human development – are those which have been able to adjust to shocks of various kinds, and to contain distributional conflicts without dramatic ruptures of political and institutional legitimacy. In South America, many countries have failed in this important respect.

While the principle of “prevention better than cure” is fully applicable to macroeconomic shocks crises do occur, and there is a strong need to improve policies related to social safety nets, or “social shock-absorbers”.

²² For a good overview of Latin American experience in managing capital inflows, see Agosin & French-Davis (1996).

The key objectives of poverty-focused responses to macroeconomic crises should, in the words of Nora Lustig, be to “*help the poor to maintain adequate consumption levels, ensure that the poor continue to have access to basic social services, prevent irreversible impacts on human capital and prevent dysfunctional behavioral effects such as engaging in criminal activities, prostitution, or the selling of body organs, or the development of abusive child labour*” (Lustig 1999, p. 17).

Particular attention has to be paid to the burden on women who - in addition to constituting a majority of South America’s poor – normally carry the primary responsibility for maintaining cohesion within families and societies and who often bear the brunt of the consequences of economic crises and deteriorating social services.

Public works programmes, often in the form of minor infrastructural investments such as rural roads, have played an important role in both developed and developing countries. One advantage is the flexibility of such programmes – they can rather easily be expanded or reduced for countercyclical purposes. Another advantage is the fact that they are self-targeting; wages are generally so low that only groups with the poorest prospects of finding alternative employment have incentives to join the programmes (see also comments on the so-called social funds at the end of this chapter).

A better coverage of unemployment insurance schemes could be helpful; it would not only reduce social costs during recessions and prevent cyclical poverty from becoming entrenched, it would also act as a countercyclical instrument. At present, only a minority of South American countries possess some type of unemployment compensation system, and even in these countries, only a minor part of the labor force is eligible; rural and informal sector workers, the unemployed and many others outside the formal labor market lack all forms of protection.

There is also a need to improve the redistributive effects of public spending on social security and social sector development.

Social Spending in South America: Prevailing Patterns and Distributional Effects

General Lessons

While economic growth is important for poverty reduction, the very poorest groups may not improve their lot automatically as a result of good macroeconomic policies and rapid growth. Economic growth needs to be supported and underpinned by public expenditure on social development.

There are strong synergies between income growth and social development. Interventions in health, nutrition, improved water and sanitation, education and income complement each other, and the economic return to investments in each area increases the positive impact of other investments as well.

If we look at countries which have performed well in poverty reduction and social development, a number of key principles emerge. In a large comparative study of “success stories” in terms of social progress, ten countries which have managed to achieve sustained improvements in child survival and educational levels were analysed²³. The cases chosen represent most developing

²³ Mehrotra and Jolly (1997). The ten countries were Barbados, Botswana, Costa Rica, Cuba, the Indian state of Kerala, South Korea, Malaysia, Mauritius, Sri Lanka and Zimbabwe. No South American country could qualify among the “success stories”.

regions, and offer a variety of different routes to high educational status, decreased child mortality and reduced fertility, but a few major conclusions deserve to be highlighted:

“One unmistakable lesson from the success stories is that in those countries which grew rapidly, human development came before and simultaneous with rapid economic growth, generating a virtuous circle of growth and social development. Equally important, it is possible for poor countries at an early stage of development to invest in the health and education of their population... That demonstrates that the poorest countries may not have to wait until they become rich to make that investment.”²⁴

Among the countries analysed, certain common elements of good policies and practices are also striking:

- all countries covered by the study considered universal access to basic social services as a public sector priority, although the private-public sector mix of social service delivery varied widely;
- they spent more on basic social services than the average for countries on the same level of per capita income;
- within the health sector much attention was paid to reproductive health services, with mother and child health care as the first priority, and to preventive rather than curative services;
- in education, the countries devoted a relatively high share of all expenditure to primary education;
- they made better use of their limited resources by (i) reaching the poorest (equity); improving the impact of social spending (efficiency); and (iii) providing an integrated package of basic social services so that their combined impact was greater than the sum of the parts;
- they protected the budget for basic social services during periods of crisis and austerity.

The authors of the study also conclude, however, that without economic growth, the possibilities for further improvements in health and education are limited. The fact that the sample of good performers included several countries whose economic growth has remained low and at times even negative (such as Zimbabwe and Cuba) also demonstrates that while social development may be a necessary condition for sustained economic growth, it is certainly not a sufficient condition.

The South American Pattern

With few exceptions - in particular Chile – the South American countries are characterised by a below-average performance if we compare a number of social indicators with the countries' per capita income levels. For example, in areas related to literacy, infant mortality and life expectancy, South American middle-income countries such as Brazil, Venezuela and Colombia are outperformed by many Asian countries with a lower per capita income.

This negative discrepancy between social development and income level is, of course, largely the consequence of the region's exceptionally unequal distribution of income. Unfortunately, the

²⁴ Ibid. p. 56. To illustrate that even poor countries can invest heavily in their children we could also use Sweden in the 19th century. As early as in 1875, when Sweden's per capita income was far lower than that of today's Latin America, the rate of literacy among nineteen-year old Swedes was 99 per cent. For further data on Sweden's educational achievements in the 19th century, see de Vylder (1996).

prevailing pattern of public social spending does not do enough to change this pattern and break the poverty cycle.

To begin with, a relatively large share of all public social spending in several countries is absorbed by social security, for which the coverage tends to be very narrow and which excludes the poorest strata of the population.

Table 16 shows the sectoral allocation of public social spending for selected Latin American countries. To enable a comparison with other countries, corresponding data from Thailand, the Philippines and the United Kingdom are also shown.

Table 17. Sectoral allocation of central government social spending for selected countries 1990–93.

	Health care	Education	Housing	Social security
Argentina	25.9	20.1	7.9	46.1
Brazil	21.4	11.3	7.1	60.2
Colombia	15.4	34.6	3.9	46.1
Philippines	12.7	66.4	8.0	12.8
Thailand	19.7	61.9	8.6	9.8
United Kingdom*	23.4	20.8	9.3	46.5

* Includes local government spending.

Source: Lloyd-Sherlock (2000), p. 105.

The table illustrates that allocations in South American middle-income countries are not very different from those of a developed country, the UK. Conversely, there are substantial differences in spending patterns between Latin America and the two Asian countries. By far the largest proportion of funds was allocated to social security programmes, while the Asian pattern is very different: more funds to investments in human capital in health and education, and less to social security.

Social security is excellent. The problem is that in South America social security – which is dominated by old-age pensions which typically absorb over two-thirds of social security expenditure – by and large fails to reach the poorest and most vulnerable groups. In the OECD countries, over 90 per cent of the adult population is typically covered by social insurance. In Latin America, however, a relatively privileged minority captures most of the social security funds; as emphasised by Lloyd-Sherlock (*ibid*, p. 112), many social security schemes in Latin America are markedly regressive and could even be said to represent a form of “inverted targeting”.

Family allowances providing support to families with children are largely non-existent, and account for an extremely low proportion of all spending on social security in the LAC region.

The pattern of social spending has changed somewhat in the 1990s, with relatively more funds allocated to health and education. According to ECLAC (*Equity... 2000*, Chapter 6) it is estimated that 44 per cent of the increase in social expenditures over the 1990s went to education and health, while 41 per cent was spent on social security, mainly pensions. The remainder, 15 per cent, was directed to other areas such as housing and social assistance.

The redistributive impact of basic social services is distinctly better than that of the social security programmes. On the whole, the most progressive allocations – in other words, those whose benefits are most concentrated to low-income households – are those that go to primary

and secondary education, health care and nutrition. Spending on social security and university education is the least progressive, while social housing programmes are in an intermediate position. The differences are large between the various countries, however.

“Taken as a whole”, the ECLAC study concludes, “social spending is highly redistributive in all the countries, particularly if social security spending is excluded. On average, the share of the poorest households in public spending, leaving aside social security, is 51 per cent, which is 3.2 times their share in the primary income distribution” (ibid, p. 171).

Much can also be done to improve the redistributive impact within the different social sectors. For example, the public health care system across the region suffers from a strong bias towards expensive curative interventions instead of more cost-effective promotion and prevention services.

The curative bias is not only inequitable, it is also inefficient. Richer groups benefit disproportionately from high-cost services such as advanced surgery, yet the same money could have a far greater impact on the overall health status of the population, both rich and poor, if allocated to prevention.

Most health systems also suffer from a pronounced urban bias; many rural poor, not least among indigenous communities, are not reached at all by quality health care.

It is also important to enhance the potential synergies in interventions in areas such as health, nutrition and education. Simple school-feeding programmes can, for example, greatly improve the children’s ability to benefit from education as well as increasing the parents’ willingness to send their children to school.

Targeted Support to Particularly Vulnerable Groups

In addition to economic growth and social sector development, an effective poverty reduction strategy requires, as a third pillar, an element of targeted support to particularly vulnerable groups. Without concerted public action directed at the poorest families there will always be those who are left behind, unable to break the poverty cycle.

In key areas for human development, the coverage of public services should preferably be as non-excluding as possible. Access to primary health and education services should be regarded as general human rights.

In other areas, however, targeting may be necessary in order to reach the poorest and most vulnerable groups. Support to early childhood development for children growing up in disadvantaged circumstances is one example.

It should however be stressed that individual targeting based on means-testing necessarily carries several kinds of costs. Careful selection of beneficiaries below a certain income is administratively costly, and open to abuse, and may create distorted incentives. Also, the benefits may in part accrue to a big bureaucracy administering the programme.

There are also other, less tangible costs. *“Benefits meant exclusively for the poor often end up being poor benefits”*, observes Amartya Sen, who emphasises a number of negative aspects related to loss of privacy and autonomy for the individuals who are being scrutinised, often in a humiliating way which undermines self-respect. *“Any system that requires people to be identified as poor”*, writes Sen, *“and that is seen as a special benefaction for those who cannot fend for themselves would tend to have some effects of their*

self-respect as well as on the respect accorded them by others. These features do, of course, have their incentive effects as well, but quite aside from those indirect consequences, there are also direct costs and losses involved in feeling – and being – stigmatised.” (Sen, 1995, p. 13).

It should also be stressed that while certain transfer programmes are needed for some particularly poor and vulnerable groups, the overall emphasis must be on economic growth biased in favour of the poor. The role of pure income transfers in poverty alleviation is quite limited; rather, sustainable poverty reduction programmes must focus on increasing the productive capacity of, and opportunities for, poor people: education and training, improved access to productive assets and small-scale credit, sustainable management of natural resources, empowerment of the poor through the establishment of local organisations, etc.

An alternative to individual targeting can be targeting to particular areas or groups of people where poverty is widespread. The establishment of so-called social funds, or social emergency funds, in several South American countries represents attempts to combine the provision of employment with the creation of small-scale physical and social infrastructure. Since these funds have attracted much attention, and received external assistance from many donors, including Sida, a few comments may be justified.

A Note on Social Funds

Social funds have (under different names) spread rapidly in developing countries since the well-known Social Emergency Fund was established in Bolivia in 1987, and have since then been introduced in more than 70 countries (including Bolivia, Ecuador, Peru and Chile), usually with the support of external funds.

The first funds were typically designed as shock absorbers and temporary institutions to mitigate the adverse impact of structural adjustment programmes. As objectives have evolved over time, the social funds have in many countries become semi-permanent institutions to be used to create employment and to build up assets for the poor in social and physical infrastructure (rural roads, schools, dams, water and sanitation, health clinics, etc.).

Social funds are typically set up as autonomous institutions to provide funding to local organisations (local governments, NGOs, and others). Normally, the funds are demand-driven; they do not themselves identify projects, but respond to requests generated by local communities. Ideally, this should lead to a higher level of local commitment and community participation than in projects implemented by the ordinary line ministries.

Like in most conventional public works programmes employment through the social funds is largely self-targeting.

It is difficult to generalise about experiences with social funds from a many different countries and projects. A few general observations, based on a large number of evaluations and studies, can however be made.²⁵

One conclusion is that *ex ante* macro policies have always had a greater impact on employment, incomes and poverty than *ex post* social funds. In most cases, the number of jobs added represented less than one per cent of total employment. This was partly due to limited funding and inadequate sequencing, as social funds were generally introduced after several years of crisis and adjustment.

²⁵ This section is largely based on Stewart & van der Geest (1995) and Cornia (1999).

In order to have a large impact on poverty reduction the funds would not only need much larger resources, planning and targeting would also need to be improved.

While the demand-driven nature of the mini-projects that have been executed has often been of great value, the selection of projects has also been subject to pressures from local elites, including local politicians who are in need of demonstration projects.

The high dependence upon external funding has often endangered the funds' sustainability. Programmes with higher sustainability have had more diversified sources of funding, including specifically allocated domestic taxes (Stewart & van der Geest, 1995). As regards replicability, Cornia (1999) observes that while most social funds were implemented more rapidly than ordinary government programmes unit costs tended to be higher, making their replication at the national level difficult or impossible.

While there are also good examples, where social funds have been able to provide some countercyclical relief in a flexible and decentralised manner, available evidence lends support to Stewart's and van der Geest's rather pessimistic assessment:

“In summary, this review has shown that the ‘add-on’ temporary institutions, depending heavily on external funds, have been poorly targeted and have not been able to provide for effective poverty reduction during adjustment – i.e. they represent very inadequate safety nets. They seem often to constitute political panacea during unpopular adjustment programmes. Their main strength appears to have been their ability to create useful economic and social infrastructure, on a small scale, relatively rapidly.” (1995, p. 134).

At present, the role of social funds in South America appears to be declining.

Chapter 4. Conclusions and the Role of Development Cooperation

The Poverty Reduction Goal – within Reach?

The earlier discussion in the present paper has concentrated on economic and social issues and on constraints related to low and unstable growth, inequality, rising crime and violence, economic policy-making and problems of reaching the poor with current patterns of spending on social security. The general conclusions are not too encouraging: if present trends continue it will, in a majority of South American countries, be impossible to reach the Millennium Development Goal of halving the share of the population living in extreme poverty by 2015. Income growth must be higher than it has been in the past two decades, and even a somewhat higher rate of growth will not reduce poverty sufficiently enough if income distribution remains unaltered.

While it may be possible to achieve, in some South American countries, some of the other Millennium Development Goals which have not been discussed in this report (a summary of these goals is presented in Annex 1) the poverty reduction goal appears to be beyond reach.

The present situation in South America is even more problematic than when the Millennium Goals were formulated in September 2000. Economic growth is lower than in more than a decade, and a number of countries find themselves in a very strained and unstable economic and political situation.

Against this rather sombre background there is reason to have modest expectations as regards the role that development cooperation in general, and Swedish cooperation in particular, can play in assisting South America to reach the poverty reduction goal. Still, even small but crucial contributions can make a difference.

International Trends: Declining ODA to South America

In quantitative terms, official development assistance (ODA) plays a small and declining role in the Latin American economies. In per capita terms, ODA amounts to approximately 12 USD per year. As a share of GDP, the contribution of ODA has decreased from 0.4 to 0.2 per cent between 1990 and 1998 in the LAC region as a whole. By comparison, ODA accounts for almost five per cent of GDP in Sub-Saharan Africa.²⁶

Within the LAC region, a rather drastic shift from South America to Central America and the Caribbean has taken place since the 1980s. The three largest recipients of ODA in LAC in recent years have been Honduras, Nicaragua and Bolivia.

Another illustration of the marginal role of development aid to Latin America is that the total volume of ODA of around 4 billion USD represents little more than one per cent of annual export earnings and a few per cent of private capital flows (including foreign direct investment) to the region.

It should however be stressed that every comparison between private capital flows and grant aid is quite misleading: private flows are not grants but loans, or investments expecting dividends.

²⁶ Data in these introductory paragraphs is taken from World Bank, *WDR 2000/2001* and 2002 and from Randel et.al. *The Reality of Aid* (2002). ODA does not include funds from non-governmental sources.

Still, while we play around with figures: total ODA to Latin America represents less than 0.5 per cent of the region's foreign debt.

Argentina's (apparently unpayable) foreign debt of over 150 billion USD is approximately 100 times larger than the total Swedish aid budget, and one thousand times larger than Sida's annual disbursements to Latin America.

The role of ODA in major South American countries in 1998 is shown in Table 18:

Table 18. Official development assistance to major South American economies in 1998.

	ODA, dollars per capita	ODA as per cent of GDP
Argentina	2	0.0
Bolivia	79	7.5
Brazil	1	0.0
Chile	8	0.1
Colombia	4	0.2
Ecuador	14	0.9
Paraguay	15	0.9
Peru	20	0.8
Uruguay	7	0.1
Venezuela	2	0.0

Source: World Bank, *WDR 2000/2001*.

As seen above, there is only one country, Bolivia, where ODA plays a significant role. In all other countries ODA represents less than one per cent of GDP.

As regards financing for development, the important actors in South America are, in addition to the private sector, the multilateral financial institutions: the World Bank, the Inter-American Development Bank and the IMF.

Among other international organisations which assist development in South America, but whose contributions are not reflected in the data on ODA presented above, should be mentioned various UN organisations such as UNDP and the specialised agencies: UNICEF, FAO, WHO, UNAIDS, UNHCR and others. A large but unknown number of international NGOs are, of course, also providing funds and technical assistance.²⁷

Swedish Development Cooperation

Since the current Swedish development cooperation programme with South America is presented in a number of official Sida documents there is no need to present factual information in this context. Just a few observations:

Regular Swedish development cooperation with South America is concentrated to two countries: Bolivia and Colombia, which together account for over fifty per cent of Swedish aid to the region. The overriding objectives of the assistance provided are to support poverty reduction (Bolivia) and to create conditions for a national peace process and support a democratic development and respect for human rights (Colombia).

²⁷ Some useful data on the overall role of NGOs in South America are found in Randel et.al. (2002).

Swedish aid funds are to a large extent channelled through various UN and other international organisations (mainly the World Bank and the Inter-American Development Bank) as well as via non-governmental organisations. Through these channels, Swedish aid funds reach all countries in the region. The presence of Swedish NGOs – as expressed in total amounts of funds disbursed – is strongest in Brazil, Peru, Bolivia, Colombia and Ecuador. The organisations which receive the largest support from Sida for their programmes in South America are Råderna, Forum Syd, Pingstmissionen, LO/TCO and Diakonia.

Recommendations

Continued Emphasis on Human Rights

At present, the overall direction of Swedish cooperation with South America – whether through ordinary bilateral programmes, NGOs or international organisations – has a strong focus on human rights, democracy and the strengthening of civil society. I fully support these objectives.

In Colombia, all cooperation should aim at strengthening the peace efforts. This can, of course, assume many different forms – from direct support to peace negotiations to assistance to civil society organisations and the rights of the child – but without peace there will be no sustainable economic development and poverty reduction.

The fact that a majority of problems and constraints identified earlier in this report are not “technical” but are rooted in inequality, abuse of power, lack of accountability and weak institutions which largely ignore the interests of the poor makes a strengthening of democracy, human rights and empowerment of the poor a precondition for a break with past patterns of economic growth. To further these objectives can be seen as an end in itself. It can also be seen as a means to achieve a more participatory and poverty-oriented development.

The overall emphasis on strengthening democracy, civil society and empowerment of the poor should not preclude Swedish support to institution-building, in a broad sense. The weakness of many South American public institutions has been emphasised several times in this report, and the quality of a country’s institutions and governance in general is a key factor for a sustainable development favouring the poor.

Institution-building and "Niches"

Although Swedish ODA is very small in quantitative terms it could still play an important role in key “niches”: support to poverty-relevant research, the dissemination of new knowledge and ideas, the financing of activities with a regional public goods character (e.g. regional peace efforts, the struggle against HIV/AIDS, environmental problems, and others), technical assistance to central and local government and public institutions, support to civil society organisations, the provision of funds and technical assistance to innovative and replicable projects directly related to poverty alleviation and a whole range of other activities for which alternative forms of funding may be difficult to find.

In several of these areas – such as research, the development of more equitable and efficient tax collection systems, environmental management, social security and many others – Sweden enjoys certain comparative advantages. Ideally, Swedish bilateral aid could stimulate the development of long-term twinning arrangements between, for example, South American and Swedish municipalities, academic institutions, human rights organisations and sister institutions of various kinds.

Poverty Alleviation Begins with Children

The overriding objective of Swedish development cooperation is poverty reduction, and in a South American context this necessarily implies a strong focus on the issue of inequality. All forms of support should be assessed against their direct or indirect effects on inequality.

A long-term strategy against inequality must begin with the children. South American poverty is, as emphasised several times in this report, highly hereditary. The educational system is appallingly inegalitarian, and children from poor families are likely to receive low-quality primary education and to drop out before finishing secondary school; as stressed earlier, only a small minority of children of poorly educated parents are able to finish secondary school, which is generally estimated to be the threshold above which chances to escape the poverty trap are good.

Children from poor families are often disadvantaged already before starting primary school. To break the intergenerational transmission of poverty it is necessary to start with the children of the poor, and to support their human capital formation as early and as comprehensively as possible. Interventions that combine early stimulation, health and nutrition and education have strong synergetic effects, and the longer-term benefits of early childhood interventions include improved school performance and earnings opportunities in later years, and a reduced risk of engagement in criminal activities and drug use as adolescents and adults.

Early childhood development programmes are no panacea for development; there are, as this report has attempted to illustrate, a wide range of policies and problems at all levels that need to be addressed. If I were to single out one specific area suitable for increased development assistance I would, however, choose early childhood development programmes for poor and disadvantaged children.

A number of South American countries are today implementing various early childhood development programmes, either nationwide (as *Proyecto Integral de Desarrollo Infantil*, PIDI, in Bolivia or *Hogares de Bienestar* in Colombia) or as local or regional programmes. Swedish support to these and other programmes ought to be considered.

Budget Support and Debt Relief?

If a strong emphasis on poverty alleviation is taken seriously it means that certain forms of ongoing Swedish development assistance, such as general budget support or debt relief to Bolivia under the HIPC initiative, can be seriously questioned. Bolivia is one of South America's most inegalitarian societies – perhaps even *the* most inegalitarian (see Table 14). The better-off sectors of the population pay very low taxes (tax revenue amounts to approximately 15 per cent of GDP, and is largely collected in the form of indirect taxes) and they often prefer to keep their money abroad, thereby contributing to the debt crisis.

It is, in my opinion, difficult to justify budget support to highly inegalitarian countries where the rich hardly pay any taxes and where, in addition, corruption is generally regarded as a serious development constraint.

As regards debt relief to Bolivia, such aid has in the past largely served to facilitate the continuation of economic and social policies which hardly benefit the poor. Unless consistent efforts by the Bolivian government to give priority to poverty reduction and to reduce the country's appalling income disparities can be confirmed all forms of balance of payments support have a questionable impact on income distribution and on the situation of the poor.

Geographic Concentration?

It has often been suggested that Swedish development cooperation with South America should be concentrated to a small number of countries where poverty is most widespread and where Sweden already has a presence (in the form of a Swedish Embassy, Sida staff, traditions of cooperation, etc.).

One strong argument in favour of concentration is Sida's limited administrative capacity to handle a large number of geographically or thematically dispersed projects. There is, however, little need for heavy Swedish involvement when the assistance is administered by reliable NGOs and UN organisations. UNDP and the specialised UN organisations, such as UNICEF, UNHRC and UNAIDS, have a strong presence in South America, and a good knowledge of local conditions, but their funds are often limited. In key areas such as support to refugees, to children or the fight against HIV/AIDS, to give just a few examples, Swedish development cooperation can be highly effective if the funds are channelled through these organisations. Sweden already extends substantial support in this form, but I am convinced that there is much scope for increased cooperation.

While some forms of support – such as the twinning arrangements mentioned above – must have a pronounced “Swedish” component, including administrative work, there are many things that others are doing better, and it is important to avoid a duplication of efforts. In many areas where development cooperation can play a useful role there are already a number of agencies and NGOs operating which can be supported. In these cases, where trust exists, Sweden should relinquish all *ex ante* rights to influence the design of the projects or programmes.

The argument that Swedish cooperation should be concentrated to countries with the highest incidence of poverty (i.e. primarily the Andean countries) is, in my opinion, rather weak. All South American countries contain deep pockets of poverty, and there is no obvious correlation between a country's overall incidence of poverty, however measured, and the effectiveness of Swedish development cooperation in poverty alleviation.

“Water where it Grows”

While Sweden could and should play an active role in certain key areas where Swedish institutions and know-how can make qualitative contributions the underlying principle should be that all assistance should be demand-driven. It has been demonstrated over and over again that supply-driven aid, or aid to which a number of donor conditions are attached, is ineffective, sometimes even outright destructive. The issue of ownership is absolutely essential, and this is equally true in the case of development cooperation between domestic and foreign NGOs.

“Water where it grows” is an old saying among experienced gardeners. But don't water too much.

Annex 1

The Millennium Development Goals

Adopted by the United Nations and a majority of member countries in 2000.

1. Eradicate extreme poverty and hunger
 - 1.1 Halve the proportion of people living in extreme poverty by 2015
 - 1.2 Halve the proportion of people who suffer from hunger by 2015
2. Achieve universal primary education for both girls and boys by 2015
3. Eliminate gender disparity in primary and secondary education by 2005 and on all levels by 2015
4. Reduce the under-five mortality rate by 2/3 no later than 2015
5. Reduce the maternal mortality rate by 3/4 no later than 2015
6. Combat HIV/AIDS, malaria and other diseases
 - 6.1 Have halted and begun to reverse the spread of HIV/AIDS by 2015
 - 6.2 Have halted and begun to reverse the incidence of malaria and other major diseases
7. Ensure environmental sustainability
 - 7.1 Integrate the principles of sustainable development into country policies and programmes by 2005 and reverse the loss of environmental resources by 2015
 - 7.2 Halve the proportion of people without sustainable access to safe drinking water
 - 7.3 Have achieved a significant improvement in the lives of at least 100 million slum-dwellers by 2015
8. Develop a global partnership for development
 - 8.1 Develop an open, rule-based, predictable, non-discriminatory trading and financial system
 - 8.2 Address the special needs of the least developed countries
 - 8.3 Address the special needs of landlocked countries and small island developing states
 - 8.4 Deal comprehensively with the debt problems of developing countries
 - 8.5 Develop and implement strategies for decent and productive work for youth
 - 8.6 Provide access to affordable, essential drugs in developing countries
 - 8.7 Make the benefits of new information technologies available

List of references

- Agosin, Manuel and Ffrench-Davis, Ricardo. *Managing Capital Inflows in Latin America*. In ul Haq (ed.) 1966
- Aldaz-Carroll, Enrique and Morán, Ricardo. *Family Factors in the Intergenerational Transmission of Poverty: Empirical Results and Policy Implications for Latin America*. Inter-American Development Bank, mimeo, Washington D.C. October 1999
- Basu, Kaushik. *Development as an Instrument of Poverty Eradication: Measurement and Evaluation*. Background paper for the 1996 *Human Development Report*, mimeo, New York 1995
- Bourguignon, Francois. *Crime, Violence, and Inequitable Development*. In Boris Pleskovic and Joseph E. Stiglitz (eds.) *Annual World Bank Conference on Development Economics 1999*, the World Bank, Washington D.C. 1999
- Castañeda, Tarsicio and Aldaz-Carroll, Enrique. *The Intergenerational Transmission of Poverty: Some Causes and Policy Implications*, Inter-American Development Bank, mimeo, Washington D.C., March 1999
- Cornia, Giovanni Andrea and Jolly, Richard and Stewart, Frances. *Adjustment with a Human Face*. Oxford University Press, Oxford 1987
- Cornia, Giovanni Andrea. *Social Funds in Stabilization and Adjustment Programmes*. The United Nations University WIDER, Helsinki 1999
- Economic Commission for Latin America and the Caribbean (ECLAC). *Equity, Development and Citizenship*. Paper prepared for the 28th session of ECLAC, Mexico City, 3–7 April 2000
- ECLAC. *Education and Employment. The Two 'Master Keys' to Development*, Santiago de Chile, 2000
- The Economist*, May 11th, 2002. *Education in Latin America*
- Ferreira, Fransisco and Leite, Phillippe. *Meeting the Millennium Poverty Targets: Simulation Results for Brazil*. UNDP, web address www.undp.org/rblac/targets
- Ffrench-Davis, Ricardo. *Crisis financieras en paises exitosos*. CEPAL/McGrawHill, Santiago de Chile 2001
- ul Haq, Mahbub and Kaul, Inge and Grunberg, Isabelle (eds.). *The Tobin Tax. Coping with Financial Volatility*. Oxford University Press, Oxford 1996
- Holmqvist, Göran. *Latin American Crime and the Issue of Inequality*. In *Iberoamericana 2000:2*, Institute of Latin American Studies, Stockholm University
- IDB (Inter-American Development Bank). *Tras una década de reformas en América Latina. Cuáles son los próximos pasos?* Washington D.C. 1997
- IDB. *Breaking the Poverty Cycle: Investing in Early Childhood*. Washington D.C., 1999
- IDB. *Latin American Economic Policies*. Vol. 17, First Quarter 2002.

IFAD (International Fund for Agricultural Development). *Rural Poverty Report 2001*. Oxford University Press, Oxford 2001

IMF (International Monetary Fund). *World Economic Outlook* various issues

Kanbur, Ravi. *Economic Policy, Distribution and Poverty: The Nature of Disagreements*. Report to Globkom, December 2000. Also available at www.people.cornell.edu/pages/sk145/

Latin American Newsletters. *Debt & External Vulnerability in Latin America. Special Reports*, April 2002.

Lloyd-Sherlock, Peter. *Failing the Needy: Public Social Spending in Latin America*. In *Journal of International Development*, Vol. 12, No. 1, June 2000

Londoño, Juan Luis and Guerrero, Rodrigo. *Violencia en América Latina: Epidemiología y Costos*. Banco Interamericano de Desarrollo, Serie de documentos de trabajo R-375, Washington, Agosto 1999

Lustig, Nora. *Crisis and the Poor: Socially Responsible Macroeconomics*. Presidential Address to the Fourth Annual Meeting of the Latin American and Caribbean Association, Santiago de Chile, October 22, 1999

Mehrotra, Santosh and Jolly, Richard. *Development with a Human Face. Experiences in Social Achievements and Economic Growth*. Clarendon Press, Oxford 1997

Mellor, John W. *The Relation between Growth in Agriculture and Poverty Reduction*. Paper prepared for the USAID, mimeo, Washington D.C., November 1999

Myers, Robert. *The Twelve Who Survive: Strengthening Programmes of Early Childhood Development in the Third World*. High/Scope Press, Michigan 1995

Nead, Kimberly and van de Walle, Dominique. *Public Spending and the Poor*. World Bank and Johns Hopkins University Press, Baltimore and London, 1995

Randel, Judith and German, Tony and Ewing, Deborah. *The Reality of Aid 2002. An Independent Review of Poverty Reduction and Development Assistance*. IBON Foundation, Manila 2002

Raszynski, Dagmar. *Chile*. In Cornia et.al. (1987)

Rodrik, Dani (1999a). *Why is there so much Economic Insecurity in Latin America?* Mimeo, Harvard University, available at web address www.ksg.harvard.edu/rodrik/

Rodrik, Dani (1999b). *The New Global Economy and Developing Countries: Making Openness Work*. Johns Hopkins University Press, Washington D.C.

Rodrik, Dani. *The Global Governance of Trade As If Development Really Mattered*. Paper prepared for UNDP, mimeo, October 2001

Sen, Amartya. *The Political Economy of Targeting*. In Nead and van de Walle (1995)

Stewart, Francis. *Adjustment and Poverty. Options and Choices*. Routledge, London and New York, 1995

Stewart, Francis and van der Geest, Willem. *Adjustment and Social Funds: Panacea or Effective Poverty Reduction?* in Stewart (1995)

UNDP (United Nations Development Programme), web address www.undp.org

UNDP. *Human Development Report (HDR)*. Various issues

UNRISD (United Nations Research Institute for Social Development). *Visible Hands. Taking Responsibility for Social Development*. Geneva 2000

Valenzuela, Pedro. *Conflict Analysis – Colombia, Bolivia and the Andean Region*. Report prepared for Sida, Uppsala, May 2002

de Vylder, Stefan. *The Rise and Fall of the 'Swedish Model'*. UNDP, Human Development Report Office, *Occasional Papers* no. 26, New York 1996

de Vylder, Stefan. *Finanskriser och krishantering*. In *Ekonomisk Debatt* 1999:2

World Bank. *World Development Report (WDR)*. Various issues.



SWEDISH INTERNATIONAL DEVELOPMENT COOPERATION AGENCY

S-105 25 Stockholm, Sweden

Tel: +46 (0)8-698 50 00. Fax: +46 (0)8-20 88 64

Homepage: <http://www.sida.se>