THE AMERICAS IN MOTION:
Looking Ahead

30TH ANNIVERSARY SOL M. LINOWITZ FORUM COMMEMORATIVE VOLUME

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30 INTER-AMERICAN DIALOGUE YEARS

BOARD OF DIRECTORS

The Americas in Motion: Looking Ahead

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COMMEMORATIVE VOLUME

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Preface

In April 1983, the Inter-American Dialogue issued its first report on the state of inter-American relations and the hemispheric policy agenda. The past three decades have witnessed deep-seated economic, political, and social changes that would have been difficult to imagine in the early 1980s. Today's regional and global landscapes bear scant resemblance to the prevailing scenarios back then.

This commemorative volume reflects on the dramatic transformations in US-Latin American relations over the past thirty years and, more crucially, explores what changes should be anticipated over the next three decades. In keeping with the Dialogue's role and mission, this forward-looking exercise seeks to inform the terms of debate and influence decision-making in the Americas. Our aim is to stimulate broad and spirited public discussion about where the Western Hemisphere is headed.

The volume draws in part on several of the background papers prepared for the Dialogue's 30th anniversary Sol M. Linowitz Forum in Washington, DC, in June 2012. That forum, which was the ninth honoring the Dialogue's founding chair, offered an opportunity for Dialogue members to review the most germane and pressing issues in the hemisphere and to propose practical recommendations for constructive and cooperative action.

The topics addressed in this volume are necessarily selective. They include a review of US-Latin American relations, the outlook for energy cooperation, the current and prospective role of China in the region, the political implications of the expanding middle class, the emerging social dynamics in the region, and the impact of long-term global trends on Latin America. We are grateful to the following authors and commentators for their fine and thoughtful contributions: Ricardo Lagos, Abraham Lowenthal, Genaro Arriagada, Margaret Myers, Francis Fukuyama, George Gray Molina, Sergio Bitar, Patricia Vasquez, Alejandro Izquierdo, Barbara Kotschwar, Michael Reid, Augusto de la Torre, and Diego Sánchez-Ancochea.

Special thanks are due to Joan Caivano, who directs the Dialogue's special projects, for her superb management and coordination of this effort. Finally, this report would not have been possible without the generous support provided by the Ford Foundation, CAF—Development Bank of Latin America, and the Tinker Foundation.

Michael Shifter
President

Foreword

If the history of the past three decades is any guide, to reflect on possible changes in the hemisphere over the next three is a daunting task. Yet it is a necessary one. It is our responsibility to begin a thoughtful discussion about the scenarios that the hemisphere may confront in the future. This volume from the Inter-American Dialogue is a valuable contribution toward that goal.

New political, economic, and social factors are intersecting with new actors and partnerships—all of which are sure to profoundly shape Latin America's future. Politically, the most salient development will be the growing demand for participation, thanks to expanding social networks that, in turn, empower new social actors. Stunning advances in technology carry huge political implications, including increased accountability.

Economic changes have also been striking as Latin America evolves into a solidly middle-income region. Over the past decade, South American countries (except Venezuela) saw a growth rate more than double that of OECD countries. Annual per capita income in most countries is expected to reach $20,000. Yet a crucial challenge remains on how to improve social indicators and income distribution. In this respect, the United States is moving in a worrying direction as its inequalities grow larger, a shift that could also affect Latin America.

As far as social policy, the work ahead will be enormous. Governments will be called to devise effective policies to not only reduce poverty but to meet the high demands and expectations of the middle class. Pursuit of these objectives will be expensive and difficult; most politicians will resist altering the status quo. Latin America will be looking with keen interest to the contrasting paradigms that have long been in place in Europe and the United States.

The changes and challenges ahead will involve new players, with Asia, and especially China, taking on expanded roles. When the Inter-American Dialogue was created thirty years ago, China was not a consideration. How important will it be thirty years from now? Beyond dialogue in this hemisphere, a partnership among China, the United States, and Latin America is needed. Since the "Atlantic Alliance" involved not only countries on the Atlantic, there is no reason why a "Pacific Alliance" should not include all of Latin America.

The Dialogue's role is more fundamental than ever. Looking ahead, the focus should not only be on US policy toward the region, but rather on devising fresh and imaginative approaches—on drugs, immigration, trade, new financial architecture, climate change—that affect the well-being of all the hemisphere's citizens.

Ricardo Lagos
Chair Emeritus

Rethinking US-Latin American Relations: Thirty Years of Transformations

BY ABRAHAM F. LOWENTHAL

This essay is adapted from the author's presentation at the June 8, 2012, Sol M. Linowitz Forum of the Inter-American Dialogue.

Thirty years ago, Latin America was gripped by a gathering financial crisis and economic recession. Unsustainable external debts and fiscal deficits had come home to roost. In 1982—the first year in forty that the gross income in Latin America had declined—financial institutions were faltering, and poverty and unemployment were rising. Import substitution industrialization and statist economies had largely exhausted their benefits. What was to become known as the Lost Decade was underway.

After many years of relative calm, military conflicts were percolating. The long-term dispute between Argentina and the United Kingdom over the Malvinas-Falklands Islands produced the first outright military clash in memory between a Latin American nation and one from outside the hemisphere. Intense frictions eroded relationships between Argentina and Chile, Peru and Ecuador, with armed conflict a real possibility. Border tensions grew between Venezuela and Colombia, Guatemala and Belize, Nicaragua and Colombia.

Civil wars in Central America, with escalating involvement by nations beyond the isthmus, including Cuba and the United States, were increasingly violent and deeply worrisome. The United States engaged in overt and covert military intervention in Central America, breaching its own and international laws. Repressive authoritarian regimes (especially in Argentina, Chile, and Uruguay) systematically violated human rights, and the new US administration of Ronald Reagan appeared to condone their behavior.

Within the United States, immigration from Latin America was picking up but, owing to domestic economic difficulties, there were calls for restrictionist policies. Actions by the Federal Reserve to reverse inflation in the United States exacerbated Latin America's economic and financial pressures.

The United States was highly relevant to many Latin American problems: debt, trade, growth, poverty, repression, and the violent conflicts in Central America. Washington's approach to these issues was mainly structured by the Western Hemisphere idea, that is, the notion that the countries of the Americas stand apart from the rest of the world in a special relationship with each other, with the United States in the lead, and by the still powerful framework of the Cold War rivalry with the Soviet Union. US officials recognized that there was enormous diversity among the more than thirty countries of Latin America and the Caribbean, with their different sizes, colonial heritages, indigenous populations, immigrant stock, geography, natural resource endowments, and relations with the world economy. But they nevertheless tended to think in broad regional terms, to see the countries of Latin America and the United States as sharing broad interests and perspectives, and to seek cooperative inter-American approaches primarily to solve

problems that were of high priority to the United States, not those emphasized in Latin America and the Caribbean.

Those who convened the Inter-American Dialogue in 1982 thought that Washington's concepts and priorities in regard to Latin America were off base and out of date. We were deeply concerned about the intense US focus on Central America, the insensitivity of the US government to Latin America's mounting economic difficulties, and the reversal of US efforts to protect fundamental human rights and promote democratic governance. And we were troubled by the frayed inter-American communications that were epitomized by Washington's tacit, if not explicit, approval to Argentina's military government to invade the Malvinas/Falklands islands, followed by US intelligence support to Great Britain in its successful campaign against the Argentine forces. Our aim in convening the exchange that led to the Dialogue's first report was to foster improved mutual exchange and understanding to ameliorate the impact of the United States on the rest of the hemisphere and to energize US leadership on shared concerns—those salient in Washington *and* those important elsewhere in the region.

Those who convened the Dialogue in 1982 thought that Washington's priorities in Latin America were off base and out of date.

We expected Latin Americans to be mostly interested in regional issues, and we concentrated our inter-American discussions on those. Everyone involved understood that the United States had global interests and policies to which its policies in the Americas were often subordinated, but we wanted to nudge the US policy agenda from the Cold War focus to shared problems and prospects for cooperation.

How different things are today. It is not just that the Cold War is over and that the Soviet Union no longer exists. Political movements against which the United States actively intervened 30 years ago currently rule in several countries of Latin America—in Brazil, Uruguay, El Salvador, and the Dominican Republic, for example. Some cooperate closely with the United States, a scenario few of us imagined in 1982. Washington is trying to extract itself from costly military engagements in the Middle East and West Asia that were not expected thirty years ago, and it faces severe threats from non-state adversaries that could not then be foreseen. The global predominance of the United States has begun to recede, and the once stable and prosperous European Union struggles with sustained difficulties. China has emerged as an increasingly active, assertive, and powerful force in global affairs. Emerging countries—India, Brazil, Korea and others—are major engines of global economic growth.

Transformations in the United States

The United States, too, has changed. Its economy has steadily moved from manufacturing to services, with productivity enhanced by revolutions in communications technologies. Its population has grown, mainly by absorbing unprecedented numbers of immigrants, and it has aged, causing more and more citizens to draw on social security and health care programs. People have migrated south and west, shifting national political dynamics. Immigrants, many of them from Mexico, Central America, and the Caribbean, have moved beyond traditional entry points to new gateway cities throughout the United States. Immigrants and their descendants are increasingly participating in and affecting US politics, and they will account for most of the expansion of the workforce through 2050.

Many of these transformations have been positive: technological innovation, increased equality of opportunity for women and ethnic minorities,

broader access to higher education and to many consumer goods, and the remarkable strengthening of research universities, attracting talent from throughout the world. In other respects, however, these have been years of deterioration. Now it is the United States that has suffered a Lost Decade. Unemployment rose sharply in 2008-09 and has been declining very slowly. Household income has fallen while the concentration of income in the United States has greatly intensified. The top 1 percent of US income earners in 1980 garnered 10 percent of the national income; by 2007, the top 1 percent accounted for 30 percent of earnings. Now it is the United States that has unsustainable levels of debt, massive fiscal imbalances, and irresponsible economic policies, often pushed by special interests and the quest for domestic political advantage.

With tax revenues down and deficits high, public services in the United States are starved, and the once-vaunted infrastructure is crumbling. The quality of primary and secondary education has declined in comparison with other industrial nations. The United States ranks in the middle of OECD countries on tests of reading skills and science and well below the OECD average in mathematics.

Economic downturn, worsening inequity, unraveling social cohesion, and decreased economic competitiveness have contributed to accelerating political deterioration. Economic and political divisions have been exacerbated by deepening cleavages between the coasts and the heartland, rural and urban, immigrants and anti-immigrants, religious and secular, and among citizens of different income levels, genders, sexual orientations, and age cohorts. With the consolidation of media enterprises and the fragmentation of media markets, polarization is growing as many citizens are exposed only to the arguments they favor. Confrontational rhetoric has replaced civic discourse.

The once enviable political institutions of the United States have become dysfunctional. Political institutions of all kinds have lost public trust: Congress, the president, parties, the media, and even the courts. Any serious exploration of Western Hemisphere relations today must take into account profound questions about the capacity of the United States to develop and sustain sound domestic and international policies.

The authoritarian rulers who led most of South and Central America in the 1970s and 1980s have been replaced by freely elected governments.

Latin America's Progress

On the whole, the story in Latin America and the Caribbean is more positive. The authoritarian rulers who led most of South and Central America in the 1970s and 1980s have been replaced in most countries by freely elected governments. That said, the nature of governing coalitions and of opposition parties ranges broadly, as do the quality and independence of judiciaries, legislatures, media, and civil society organizations. State institutions and nongovernmental organizations have developed and strengthened, albeit at different rates and with quite diverse characteristics. Political institutions have become more participatory and representative in several countries, and military rule and pervasive impunity are less common. But institutional checks on executive authority have been severely weakened in some countries, and lack of accountability is still widespread.

Continuing a trend already visible thirty years ago, most Latin American countries have become more populous, urbanized, literate, and modern. Infant mortality rates have declined, life expectancy has lengthened, and access to potable water, sewage services, electricity, and communications services have all expanded. Broad access to primary and secondary education has

Economic growth, demographic transitions, and social mobility have produced a significantly expanded middle class.

been achieved, although its quality is inconsistent and, on the whole, remains severely inadequate. Economic growth, demographic transitions, and social mobility have produced a significantly expanded middle class that is reshaping economics, society, and politics in many countries.

Economic transformations in Latin America, especially in the past fifteen years, have been striking. The 1980s were very difficult. The 1990s saw several years of good growth in a number of countries as liberal market-opening policies took hold, but the limits and vulnerabilities of the Washington Consensus approach—liberalization, openness to foreign investment, privatization, and deregulation—also became evident. Efficient states, strong and independent judicial institutions, and effective regulation are needed to make markets work well.

Impressive economic growth has taken place in the past ten years, especially in South America. At the heart of this growth has been modernized agriculture, focused on both traditional and nontraditional export products; the development of niche sectors targeted at the changing global economy; major development of natural resource endowments, much of it attracting international investment; significant (but still insufficient) investment in infrastructure; and the export of commodities, manufactured goods, and services by *multilatinas*, the Latin American-based multinationals that operate across the globe. Although some countries still export mostly primary products to a few select markets, many have diversified their exports by sector and by destination, with much-improved terms of trade.

Although these developments have produced economic dynamism that was hard to imagine thirty years ago, some sub-regions remain mired in poverty, and many countries face bottlenecks due to inadequate infrastructure, insufficiently skilled and educated workers, constrained markets, lack of innovative capacity, and the inability to convert technological advance into commercial viability. These problems, if not confronted, will threaten the region's future competitiveness.

Latin America's deep inequalities of wealth and income persist, but they have been somewhat attenuated in recent years (while equity has been worsening in the United States). Wider distribution of the benefits of expanded growth has reduced extreme poverty. This has been achieved in large degree through social programs, higher minimum wages, and conditional cash transfers to the poor.

Underlying these positive achievements has been the emergence in a number of countries—Brazil, Chile, Colombia, and Peru foremost among these—of a high level of *previsibilidad*, that is, stability of expectations about the rules of the game and about the procedures by which these rules can be altered. This stability of expectations has unleashed creative energies of all sorts—not only those of investors, foreign and domestic, but also of students, parents, nongovernmental organizations, and governments. Confidence in the operating framework facilitates longer-term and more rational decisions by all. It is much easier to overcome *cortoplacismo*—a short-term approach—and to build viable policies and institutions for the medium and long term.

The picture is not all bright, of course. Many countries of Latin America and the Caribbean remain plagued by violence, although it is no longer caused by interstate conflict or internal civil wars. The remnants of insurgent movements hanging on in Peru and Colombia are largely contained. Today's violence, responsible for as many deaths in Central America as during its brutal civil wars, arises from crime, organized and unorganized, from the response of criminal

cartels to redoubled efforts by governments to destroy or badly wound them, and from the incapacity of weak states to protect citizen security. This violence is also notably high in Venezuela, Mexico, Brazil, still in Colombia, and in parts of the Caribbean. Far from offering practical solutions, the United States is seen as one of the causes, owing to its national demand for narcotics, its insistence on criminalizing the drug trade (and thus perhaps making it more violent), and its role as a source of arms for Latin American criminals, drug cartels, and youth gangs.

Although equity indicators for many Latin American countries have improved, the region continues to be the world's most unjust. Recent gains in income distribution have been accomplished in a period of bounty. Whether they will survive a downturn if and when the commodities boom wanes is uncertain. Major segments of the population—especially the indigenous, Afro-descendants, and the rural poor—remain seriously disadvantaged in many countries. Support for democratic governance and for market-oriented policies is limited and precarious where popular frustrations are high.

Although equity indicators for Latin America have improved, the region continues to be the world's most unjust.

Latin America in a New World

Thanks to Latin America's undeniable (although uneven) social, political, and economic progress over the past thirty years, several countries in the region are now active players in international affairs. Brazil is the standout, but Mexico, Chile, Colombia, Argentina, and Peru are also no longer marginal on the world stage, nor are Venezuela and Cuba. Latin American countries are reaching out, politically and commercially, in Africa, Asia, Europe, and the Middle East, often pursuing interests and policies independent of—and even contrary to—those of the United States. Latin American nations have been building new regional economic and political organizations without the participation of the United States. Intra-Latin American sub-regional and regional initiatives—MERCOSUR, UNASUR, and CELAC—have captured the attention of many Latin Americans.[1] The Organization of American States (OAS), the Summit of the Americas, and other Pan-American institutions have weakened, their missions and effectiveness in question.

Thirty years ago, many in Washington were still deeply concerned about the involvement of the Soviet Union in the Americas, its close ties with Cuba, support for the Sandinistas in Nicaragua, solidarity with the FMLN in El Salvador, and links with Peru's military. Now there is no Soviet Union, and Russia's presence in the Americas is modest and limited.

By contrast, China was of little economic consequence in Latin America thirty years ago. Today it is the most important trading partner for several South American nations and the largest international investor and lender for a few. China's presence in the Western Hemisphere surpasses that ever achieved by the former Soviet Union, by Nazi Germany, or by any other extra-hemispheric powers since Latin American countries achieved their independence from colonial rule. A number of Latin American countries have also developed significant economic relationships with Japan, Korea, India, and Southeast Asia. Commercial relations

[1] MERCOSUR (or MERCOSUL in Portuguese) is a the common market arrangement involving Argentina, Brazil, Paraguay, Uruguay, and Venezuela as full members, Bolivia as an accessing member, and Chile, Colombia, Ecuador, and Peru as associate members; UNASUR (UNASUL in Portuguese) is the Union of South American Nations, a security and political organization comprising the 12 South American nations with an affiliated South American Defense Council on security questions; CELAC, the Community of Latin American and Caribbean States, incorporates all countries of the Americas except Canada and the United States.

Mexico, the second largest trading partner of the United States, sends 80 percent of its exports north.

with Europe continue to be substantial, with efforts in both directions to enhance them.

Mexico and the closest neighbors of the United States in the Caribbean and Central America remain intimately tied to the United States—ever more so in demographic, labor market, commercial, financial, and cultural terms. Mexico, the second largest trading partner of the United States, sends 80 percent of its exports north; its economy depends on tourism, remittances, and investment from the United States, as well as from the returns on growing Mexican investments in the United States. More than 10 percent of Mexico's labor force works in the United States. New levels of cooperation and of conflict on many matters—intermestic issues at the boundary of international and domestic policy, with facets of each, and causes and impacts on both sides of increasingly porous borders—make managing these relations particularly challenging. The key issues are not traditional foreign policy questions but, rather, public health, education, narcotics, violence, law enforcement, drivers' licenses, retirement communities, medical insurance benefits, and many other practical matters.

The countries of South America, meanwhile, enjoy much more diversity in the number and quality of their international relationships than they did thirty years ago. South Americans are, thus, less inclined to look first for inter-American approaches to broader global questions.

Different Paths

The vision of Latin America as a coherent and increasingly unified region, which was problematic from the start, was reinforced in the early 1990s when it was common to see Latin American countries as traveling at different rates in the same direction on the same path, with Chile in the lead. In more recent years, however, it has become clear that the diverse countries of Latin America are embarked on different journeys. There are many variants, but the fundamental divide splits two clusters: the Bolivarian Alternative countries and the rest.

The Bolivarian Alternative countries (Cuba, Venezuela, Bolivia, Ecuador, Nicaragua, and perhaps Argentina) are committed to more inclusionary and equitable approaches to development. They are profoundly suspicious of globalization and market capitalism, and they prefer plebiscitary democracy to liberal representative institutions. Most of the other countries, including some of the more influential nations, are trying to adjust to globalization by harnessing the dynamic energies and substantial resources available from global capitalism. But they are also trying to counter capitalism's negative effects on equity and social cohesion through redistributive policies and by strengthening the institutions and counterbalances of effective democratic governance.

These two clusters, heterogeneous within each group, are in practice more fuzzy than absolutely distinct, and they are works-in-progress rather than settled ideological models. Countries in both clusters combine pragmatic and ideological elements. In different ways, all seek better terms of engagement with international capital and to improve the terms of economic exchange with the rest of the world. Countries in both clusters respond tactically to domestic pressures and to international constraints and opportunities, rather than conform to consistent templates or rigid dogma. And all these countries are shaped in part by the personal qualities and circumstances of individual political leaders, by the legacies of their historical experiences, and by their divergent institutions.

Looking Forward

After thirty years of transformations, the United States is an aging society with diminished international power and influence. It badly needs to invest in education and infrastructure, restore fiscal solvency, expand exports, and revitalize its political institutions. The United States is juxtaposed in the Western Hemisphere with Latin American and Caribbean countries that, on the whole, are strengthening and diversifying their economies, bolstering their institutions, expanding their middle classes, and actively engaging in productive international relationships.

The coming years could be auspicious for inter-American cooperation, not because of US philanthropy nor Washington's fear of regional trends or of external influence in Latin America, but because transformations in the Americas, north and south, create potential synergies and mutual opportunities. On issues ranging from trade to energy, climate change to public health, higher education to infrastructure development, the coming years could see unprecedented exchange.

An important opportunity now exists to refashion one of the most important bilateral relations in the world: between Mexico and the United States. Complementary demographic, economic, social, and political trends in the two countries may make it possible to build cooperation on an intimate and sustained basis within a broad range of issues: infrastructure development, energy production, higher education, public health, migration and labor markets, border management, and citizen security. New concepts, policies, norms, and institutions will be needed to manage this increasingly vibrant but complex relationship. Building these, in turn, will require changed mindsets and attitudes in both countries.[2]

> Synergies exist on trade, energy, climate change, public health, higher education and infrastructure development.

The time has also come for focused efforts to encourage synergy between the United States and Brazil on a broad range of issues not confined to this hemisphere: responding to climate change, preventing and containing global pandemics, curbing nuclear proliferation, strengthening the institutions and arrangements for global governance, and reforming international rules and practices for trade, finance, investment, intellectual property, and the transfer of technologies. There are also huge opportunities to build cooperation in higher education with initiatives that would pay handsome dividends over time.

At this stage, the countries of Latin America and the Caribbean are not natural followers of US leads; they define their own interests and forge their own approaches. Policies and attitudes of presumption and imposition by the United States no longer work. Institutions such as the OAS that rely on notions of fundamental harmony in the Americas need to be rethought. Strengthening the OAS requires more than changing personnel, budgets, or administrative practices. It calls for joint exploration by Latin American countries, the United States, and Canada of the specific issues on which concrete regional programs, or cooperation in broader global arenas, make sense. More generally, that is the challenge of inter-American relations after thirty years of transformations.

[2] For an important statement about these needed changes, see Robert Pastor, *The North American Idea* (Oxford University Press, 2010).

Energy in Latin America 2010–2020: Headed for a Lost Decade?

BY GENARO ARRIAGADA

Latin American politics is known for mirages that obscure the severity of problems and defer their solution. This is what seems to be happening with energy issues. The energy sector had been cited time and again as being among the most problematic in the Americas, sparking numerous statements, speeches by heads of state, and a few summits. In the middle of the last decade, however, this mindset changed. On the strength of Brazilian success in the pre-salt fields, confirmation of Venezuela's ultra-heavy crude oil reserves, and hopes, albeit still vague, about shale gas, Latin America has begun to emerge as a successful region. There is optimism that in this decade and the next it will play a crucial role in world energy, and that its exportable surplus could relieve China's fuel shortages.

This optimistic, self-satisfied view today appears questionable. Overall, energy problems in the region—notwithstanding individual country or industry successes—have, if anything, worsened. The future is bright in terms of potential, but in the past ten years the concrete results have been mediocre. The region's contribution to alleviating the world's energy plight, at least in this decade, was an optimistic illusion that is now being derailed by tough realities. The reasons for optimism will likely continue to fade, barring major political changes.

The Vulnerabilities of Central America and the Caribbean

When it comes to energy, Latin America exhibits many weaknesses.

In terms of energy, there is not one Latin America but several. One is energy-rich South America, flush with diverse resources, including abundant oil, hydroelectricity, gas, coal, and non-traditional renewable energy sources. That contrasts with the energy-poor regions of Central America and the Caribbean, which include twenty-three nations with an energy deficit (where domestic consumption exceeds national output) and only one, Trinidad and Tobago, with a surplus. Only two of the countries, Guatemala and Cuba, produce oil, though not enough to satisfy internal demand.

In many of these nations, oil accounts for upwards of 60 percent of the energy mix. These countries have no gas at all except Trinidad and Tobago, which has a significant exportable surplus. Hydroelectric resources are modest but are among the few sources of primary energy available. In the poorest countries, such as Nicaragua and Haiti, traditional biomass, normally a sign of severe poverty, makes up more than 40 percent of the energy mix.

Energy shortfalls impose a severe constraint on development and social progress. At one time these difficulties were mitigated by a joint Venezuela-Mexico initiative (the San José Accord), which supplemented the region's energy resources. But it

In Cuba, disruption of Venezuelan supplies and subsidies could trigger a crisis akin to the "special period" of the 1990s.

is no longer in force. At present, albeit with differences that are important to spell out, similar aid comes from the Venezuela-led PetroCaribe alliance, an initiative launched under the presidency of Hugo Chávez. In the case of Cuba, Venezuela provides oil subsidies similar in form and scale to those once delivered by the Soviet Union. This initiative is now threatened by several factors, including the decline in Venezuela's exportable surplus, the country's broader economic challenges, the change of government in Caracas, and the massive debt owed to PetroCaribe by recipient countries. For whatever the reason, a significant reduction in the flow of oil assistance would be a harsh blow to Central America and the Caribbean. In Cuba, disruption of Venezuelan supplies and subsidies could trigger a crisis akin to the "special period" of the 1990s when Soviet aid ceased.

Stagnation of Oil Production and Decline of Exportable Surplus

A review of South American oil industry performance over the past decade gives more cause for concern than for enthusiasm.

As a share of the world total, South America's proven reserves went from nearly 9 percent in 2000 to more than 17 percent in 2010. If these figures are disaggregated, however, the outlook is less encouraging. Apart from Venezuela, the region's reserves amount to only 2 percent of the world total and have hardly grown at all in the decade. Brazil accounts for more than half of the growth, and its share is set to increase significantly. Mexico's reserves, in contrast, have dropped to 0.8 percent of the world total from 1.2 percent.

The data on production are even more disturbing. Indeed, energy production in Latin America is stagnant: 6.8 million barrels per day (mbd) in 2000 and 6.9 mbd a decade later. In 2000, Latin America's share of world oil production was nearly equal to its share of world reserves. Ten years later, the ratio had dropped by half: a scant 9 percent of production versus 17 percent of reserves. Venezuela, the country with the largest reserves, had the poorest production performance, with an 800 thousand barrels per day drop during the period. Prospects in Mexico look even worse. Both reserves and production dropped by 500 thousand barrels per day between 2000 and 2010. The good news comes from Brazil, where the share of world production rose to 2.7 percent, from 1.7 percent, during the decade.

The rest of Latin America is less important as regards energy production. Colombia is a recent success story, but its prospects are uncertain because of the small size of its proven reserves. As a result of mismanagement, Argentina is an oil exporter-turned-importer. Although Ecuadoran production is stagnant, sheer reserve size could easily allow it to triple without overtaxing resources.

Proven Reserves and Oil Production by Region (Share of World Total)

	2000		2010	
	Reserv.	Prod.	Reserv.	Prod.
Middle East	63	32	54	30
South & Cent. Amer.	9	9	17	9
Europe & Eurasia	10	20	10	22
Africa	8	10	10	12
North America	6	19	6	17
Asia-Pacific	4	10	3	10
Total	100	100	100	100
Mexico	1	5	1	4

Source: *BP Statistical Review of World Energy*, June 2011.

Production Minus Domestic Consumption (thousand barrels per day)

	2000	2010	Production 2010/2000
1. Surplus energy countries			
Argentina	385	94	- 168
Colombia	476	563	+ 90
Ecuador	281	269	+ 86
Venezuela	2,680	1,706	- 768
Mexico	1,500	964	- 492
Subtotal	5,322	3,596	
2. Deficit energy countries			
Brazil	750	467	+ 869
Chile	233	305	0
Peru	53	27	+ 57
Other South & Cent. Amer	930	1,043	+ 1
Subtotal	1,966	1,842	
3. Balance (1-2)	3,356	1,754	

Source: *BP Statistical Review of World Energy*, June 2011.

Stagnant production and increased domestic demand have made a significant dent in Latin America's exportable surplus. The following table compares production and consumption for both oil exporters and net importers.

The balance is disappointing. The exportable surplus fell by 33 percent in a decade and, had it not been for Brazil's production surge, Latin America's surplus would be irrelevant. Surpluses capable of meeting increased demand in other parts of the world would be insufficient despite the fact that Latin America has the world's largest proven reserves outside the Middle East. The situation could change, but declining production in Venezuela, Mexico, and Argentina and stagnant production in Ecuador are not the result of circumstantial events. Rather, they are the result of structural factors that are hard to rectify. Difficult political decisions will be required to implement needed reforms and place Latin America's energy sector on a more productive course.

Obstacles for Hydroelectricity

Over the past fifty years, hydroelectricity has been the most distinctive—and, possibly, the most promising—characteristic of Latin America's energy production. The enormous role of this energy source sets Latin America apart from all other regions. Hydroelectricity accounts for slightly more than 6 percent of the world energy mix, but it claims a full 26 percent of the Latin American mix. It generates more than 50 percent of all electricity produced in eleven countries. In Peru, Costa Rica, and Brazil the figure is 80 percent; in Colombia and Venezuela it is 75 and 67 percent, respectively; and in Paraguay and Uruguay it is 99 percent.

But Latin America's hydroelectric sector has been losing ground. From 1966 to 1986, the sector more than quadrupled. In the decade that followed, it grew by 50 percent. From 1996 to 2006, however, it expanded by only 33 percent and, over the past five years, its growth has been a meager 1 percent a year.

Energy Mix 2010 (Consumption, %)

	Oil	Gas	Coal	Nuclear	Hydro	Renew	
Middle East	51.4	47.0	1.2	0.0	0.4	0.0	100.0
South/Cent. Am.	46.7	21.5	3.8	0.8	25.5	1.7	100.0
Europe/Eurasia	31.3	34.3	16.4	9.2	6.5	2.3	100.0
Africa	42.0	25.3	25.5	0.8	6.2	0.2	100.0
North America	38.2	27.2	19.7	7.7	5.6	1.6	100.0
Asia-Pacific	27.7	11.2	52.1	2.9	5.4	0.7	100.0
World Total	33.6	23.8	29.6	5.2	6.5	1.3	100.0

Source: *BP Statistical Review of World Energy*, June 2011.

Several factors have been advanced to explain the decline. First, there is the argument that many of the most suitable rivers, and within them the best sites, are already in use; the remainder are less important and less profitable. This is true in the United States and in Western and Central Europe but not in Latin America, where the hydroelectric potential remains enormous, so much so that less than an estimated 25 percent of potential is being effectively used. Another explanation is that low oil prices, much like in the 1990s, have made dams seem less attractive. But this is challenged by the fact that oil prices are four times higher than they were five years ago. Strictly speaking, in Latin America, the strongest foes of hydroelectricity are increasingly influential environmentalist groups that almost always and everywhere oppose construction of large dams.

The Trend Toward a Dirtier Energy Mix

The energy consumed in Latin America is the cleanest in the world for two reasons. The first and most important is hydroelectricity. Second is the fact that the share of fossil fuels in the energy mix is the lowest in the world: 72 percent versus an 87 percent world average. Within that total, and underlining the cleanliness of the regional mix, the role of coal—"the dirtiest fossil fuel"—is minor: 4 percent versus the 30 percent world average.

In order to keep the mix clean, hydroelectricity use must be maintained at current levels. Failing that, the slack will be taken up by fossil fuels, notably coal, the cheapest energy source of all. Chile is a case in point. It has rich hydroelectric potential but continues to depend on fossil fuels for most of its primary energy needs. As a result, imports of fossil fuels increased fivefold from 2003 to 2011, and all the power stations constructed since 2004 are gas- or coal-based. The notion that non-conventional renewable energy (NCRE) can fill the gap, although highly desirable, is hard to realize, at least on this scale. In fact, the share of NCRE is very small (1.8 percent of the mix), with Brazilian ethanol accounting for 70 percent of the total.

Increasing NCRE is an essential policy objective, but executing it is not easy. It usually requires heavy subsidies without which current NCRE technology cannot prosper. Many of its proponents, as commendable as their efforts may be, show little realism in opposing coal, nuclear energy, and hydroelectricity all at once. To claim that the gap left by freezing these sources can be filled within a decade by increases in NCRE is wishful thinking.

Rejection of large dams, opposition to coal and nuclear energy, and the development of NCRE will be the focus of a civic debate of the utmost importance. It will determine the success or failure of energy policies in the coming decade.

Energy Mix 2010 (Consumption, %)

	(1) Fossil	(2) Nuclear	(3) Hydro+Renew		(4) (1-3)
South/Cent. Am.	72.0	0.8	27.2	100.0	(44.8)
Europe/Eurasia	82.0	9.2	8.8	100.0	(73.2)
North America	85.1	7.7	7.2	100.0	(77.9)
Asia-Pacific	91.0	2.9	6.1	100.0	(84.9)
Africa	92.8	0.8	6.4	100.0	(86.4)
Middle East	99.6	0.0	0.4	100.0	(99.2)
World Total	87.0	5.2	7.8	100.0	(79.2)

Source: *BP Statistical Review of World Energy*, June 2011.

The Need for Political Definitions

This rundown illustrates the main characteristics shaping regional energy issues—and points toward possible solutions—but it is by no means an exhaustive inventory of Latin America's energy weaknesses. Other major factors could be mentioned, including issues around pricing and subsidies.

With its massive resources, Latin America should have an extremely promising future. Scarcity is not an obstacle to rapid energy sector growth nor are oil prices or lack of technology. Rather, the hurdles that the region must clear to develop a dynamic energy sector are institutional and political in nature.

Central America and the Caribbean require special attention. Institutions such as the Inter-American Development Bank (IDB) and the World Bank should be directing their programs to these countries. It makes no sense to focus on energy-rich South America. Assistance for sector development should not concentrate on any one component of the mix, but on a broad portfolio of energy sources (oil, gas, coal, hydroelectricity, traditional biomass, geothermal, and NCRE) as well as, most importantly, on energy integration both within these sub-regions and with Mexico and Colombia.

Technical studies for integration within Central America have been completed, but many obstacles mark the path to implementation. Progress will depend on government decisions, legislative reform governing electricity, adaptation of regulatory frameworks, new pricing systems, and integration within the industry. Action on each of these requirements will be complicated by pushback from powerful pressure groups that feel threatened by the higher level of competition attendant on integration. Since new actors will enter the market, some producers—and not because they are inefficient—will be displaced and lose influence.

If attention shifts to hydroelectricity, decision-making will clearly move from the financial centers in which the projects' technical aspects are assessed to the realm of politics. Political decisions must strive to balance the demands of energy security with tighter environmental regulations and the interests of groups that feel adversely affected by energy projects. Those who oppose dams not only raise intellectual objections, but they fuel what amounts to a social movement that joins environmental groups with agrarian communities and indigenous peoples. They are connected to each other internationally and see themselves as part of a broad struggle reaching from Río Papagayo in Mexico to Patagonia in Chile, covering Río Madeira in Brazil and the Inambari and Pakitzapango dams in Peru along the way.

> A Latin America that freezes hydroelectric development would be plunged into an energy crisis and end up with a dirtier energy mix.

Governments are forced to devise solutions since a Latin America that agrees to freeze hydroelectric development would be plunged into a major energy crisis and would end up with an energy mix that is substantially less clean.

Latin America has to break with thinking that claims a clean energy mix is one in which NCRE predominates. This is not true for any country or region on Earth. The countries that rank highest on Yale University's Environmental Performance Index have done so without relinquishing any source of energy; they assign major roles to hydroelectricity, nuclear energy, and NCRE. On average, the latter accounts for no more than 8 percent of the mix.

To end the current stagnation of oil production, institutional and political stakeholders must again play a key role. In the realm of Latin American energy—especially oil and gas—national oil companies are the largest players. Underpinned by growing resource nationalism, they will continue in that role for decades to come. Acknowledging that reality will start, rather than preclude, a debate on the oil sector's institutional arrangements since it is evident that there is no single model of a state-owned oil company. For example, both Brazil's Petrobras and Venezuela's PDVSA are state-owned, but they interact very differently with their respective governments, differ radically in terms of their corporate governance and links to society and the private sector and, last but not least, are markedly distinct in their efficiency and economic performance.

In some countries, state-owned oil companies have both a business and regulatory role. In others they do not. Petrobras and Ecopetrol are open to private investors who share in their ownership and results through shares traded in world stock markets. For both, however, state control of the company is guaranteed. Such openness forces these companies to submit to most of the control, transparency, and accountability standards governing international private enterprise. The prime determinant of national oil companies' performances is usually institutional in nature.

The next big battle for oil in Latin America will not be fought in the oilfields but in the ministerial cabinets and parliaments where decisions will be made on reforming national oil companies and the energy sector in general. In this regard, what happens with Mexico's national energy company PEMEX—the great model of a state firm from the 1940s and 1950s, with its rigid monopoly, its dependence on finance ministers, and its high levels of clientelism—will have huge influence in the region. At the same time, the worsening institutional and productive decline at PDVSA will make its reform inevitable, sooner rather than later and irrespective of the government in power.

As regards gas, the development of shale gas is worthy of careful note since there are enormous reserves in Argentina, Brazil, and Mexico. Exploitation of reserves has not been addressed in those countries. If it were, it could bring about large-scale changes in the regional energy outlook.

Finally, there is a need to revise the concepts that traditionally have shaped the geopolitics of oil between the United States and Latin America. It is widely believed in some US quarters that a shale gas revolution, as well as increases in domestic oil production and improvements in energy efficiency, will put the United States on a path to virtual self-sufficiency. If true, then, obviously, the importance of Latin America—especially Venezuela—will wane. If Mexico, in turn, does not successfully engage in energy reform in the short term, it will become a net importer of energy from the United States.

Comment by

Patricia I. Vasquez

Latin America's energy matrix depends upon hydroelectricity, the result of an abundant freshwater supply and decades of policies aimed at developing infrastructure around hydro-energy. Yet the region is moving away from that platform and increasing its dependency on dirtier sources of energy. The region's coal consumption, for example, went up by more than 7 percent last decade, from 20.1 million tons of oil equivalent in 2000, to 29.8 million in 2011, according to the *BP Statistical Review of World Energy 2012*.

Is Latin America shooting itself in the foot with regard to energy?

Latin America should enforce, not reduce, hydroelectricity—part of a clean and economically advantageous power mix—as its main source of energy. But support for dam construction today is not a popular move; politicians would rather stay away from dams, particularly during the electoral season, owing to strong opposition that has emerged in recent years from environmentalists, indigenous people, and local communities. Opposition to hydroelectricity projects in Latin America does not come out of the blue. Memories of forced displacements with no compensation and of mammoth hydroelectric constructions done under corrupt governments are still fresh. And of course, there is always someone who benefits from the conflict and tries to stir the controversy behind the scenes to keep it going. Paradoxically, opposition to dams leaves dirtier energy sources as the alternative.

Burying the controversy under the carpet for political reasons is a poor approach. There has been no concerted effort to understand the disputes and much discussion has been confrontational. All stakeholders should take a step back to examine the source of the conflict, which is not one but a combination of issues. On the part of governments, transparency is sometimes an endangered species. However, informing the population of the pros and cons of projects—how they will affect their lives, how they will be compensated—is not only a legal requirement but also a moral duty.

It is usually not true that local populations are opposed to development. Remote, marginalized communities openly demand better schooling for their children and improved health care. What they oppose are imposed decisions. If people are going to be relocated to open the way for a hydroelectric project yet are destined to remain in the dark because it is unprofitable to expand the electric grid to their community, then most certainly they will oppose the project. More often than not, communities depend on information from the civil society to make up their minds about an energy or natural resource project. Inaccurate assumptions or incongruent agendas may result in civil society discourse that does not convey the real picture or that fails to match the demands or needs of local communities.

When the private sector is involved, companies make efforts to reach out to local communities and to fund some of their basic needs: a school, a hospital. But these privately funded social development programs are usually not sustainable in the long term. A sort of paternalistic dependency develops when the social development agenda results from a top-down company effort rather than from a bottom-up participatory mechanism with the community. Educating the population is fundamental so that they can put forward their demands, make informed judgments, and remain updated about projects that directly concern them. It would be useful to create spaces where these issues can be debated, such as at universities, through the media, or in schools.

There is no such thing as a conflict-free energy project, but intense reactions can be prevented or mitigated when the debate involves an educated population with a space to express its views and grievances. Setting up this framework, however, would call for a political commitment—and that is the piece that is often missing.

China and Latin America: What Lies Ahead?

BY MARGARET MYERS

In 2001, more than a decade ago, China's then-President Jiang Zemin predicted that the 21st century would be one of Chinese-Latin American cooperation "in all areas, hand in hand." While broad-based bi-regional cooperation is a long way off, China's economic engagement with Latin America has been one of the major surprises in terms of regional economic development over the past few decades. At the end of the Mao era, just over thirty years ago, China was of little economic consequence to most Latin American nations. At that time, Chinese restaurants, immigrant communities, occasional Communist party-to-party exchanges, and other forms of political interaction formed the basis for China's limited engagement with the region.

Relations between East Asia and Latin America in the 1970s and early 1980s instead were dominated by Japan, which sought greater access to natural resources following the 1973 oil crisis. Like China's more recent engagement, Japan's initially consisted of inter-industry trade and public-private ventures involving raw materials, such as iron ore, metals, grains, wood, and salt deposits. Japan's foreign direct investment (FDI) in Latin America, much like China's current mix, was focused on resource acquisition or directed toward offshore accounts in the Caribbean.

Few would have predicted only thirty years ago that Chinese economic activity in Latin America would eventually surpass that of Japan—or even that of the United States and Europe, in certain cases. Over the course of only a decade, however, China has become a top trading partner, a major investor, and an increasingly active lender for various countries in the region. In terms of trade, according to the United Nations Economic Commission for Latin America and the Caribbean (ECLAC), China is now more important for South America's growth than the United States.

Latin America's external relations over the course of the next thirty years will be equally difficult to predict. There is little certainty with respect to China's future development—and even less so in terms of its global engagement. Moving forward, however, few would envision a Latin America absent of Chinese involvement. The Asian power has become an established economic presence in the region. The intensity of Chinese-Latin American economic engagement may decline somewhat as China's breakneck growth begins to slow, but it is unlikely to backtrack considerably. Japan, after all, has maintained strong economic linkages to Latin America despite decades of economic stagnation. It still surpasses China in terms of investment.

However China-Latin America relations develop over the next few decades, the challenge for Latin American nations, as ECLAC's Osvaldo Rosales has argued, will be to avoid a modern version of the center-periphery relationship that historically limited the region's development prospects. Responsibility increasingly will fall to the region's policymakers, national and local leaders, and even the private sector to improve regional competitiveness and achieve "win-win" relationships

with China and other partners. Efforts to address Latin America's enduring competitiveness and productivity challenges are increasingly critical as the region deepens relations not only with China, but with India, Japan, Korea, Russia, and other global powers.

A drop in Chinese growth to 7.5 percent would reduce commodity prices and exports to China by up to 10 percent and 3 percent respectively.

Chinese Economic Growth and Relations with Latin America

As the world's second-largest economy, with expected trade in the amount of US$4.8 billion by 2015, China's stability and economic prosperity factor into most any global economic calculation. China-Latin America relations, driven largely by trade, are similarly linked to China's development prospects. As has been the case since the formation of its "going-out strategy" in the 1990s, China's external relations will continue to be shaped by domestic developments, including the likelihood of slowing GDP growth over the next few years associated with an overhaul of China's development model. With this in mind, one might imagine three distinct scenarios for China-Latin America relations over the next decade and beyond.

The first, which has received considerable attention in Latin American media, involves a dramatic slowing of Chinese growth and a related decline in Chinese demand for Latin American commodities. Growth as low as 3 percent by the end of the decade, as predicted by a handful of economists, could lead to global misfortune. In Latin America, it would deal a catastrophic blow to major commodities exporters, to regional prosperity more broadly, and to burgeoning China-Latin America relations.

A drop in Chinese growth of only 1 percentage point is associated with an approximate 2 percent decline in the growth of commodities prices, according to reports from several financial institutions. A Bank of America/Merrill Lynch study suggests that a drop in Chinese growth to only 7.5 percent would reduce commodity prices and Latin American exports to China by up to 10 percent and 3 percent, respectively, with hydrocarbons and metals exporters bearing the brunt of the slowdown. Further slowing of growth would be especially detrimental to Ecuador, Venezuela, Peru, Chile, Colombia, Argentina, and Brazil, according to most calculations.

The possibility of an economic "hard landing" in China is not so far-fetched. The country faces a wide range of economic challenges that will probably intensify in coming years. Local debt, public sector inefficiencies, banking sector vulnerabilities, geographical disparities, rampant official corruption, high unemployment, resource scarcity, environmental concerns, and inflation are all possible destabilizing factors. They threaten China's growth and Chinese Communist Party credibility. Sustained growth over the next few years will require careful economic and social planning on the part of China's new leadership, but recent political turmoil suggests a lack of agreement on the way forward.

Extensive economic correction in China over the next decade would be accompanied not only by a marked decrease in Chinese global trade and investment, but also a possible decline in other forms of engagement. China has intensified its soft power initiatives in Latin America in recent years. Confucius Institutes, language and culture centers funded by the central government, are now prevalent throughout the region. CCTV en Español is broadcast in various countries. And China's People's Liberation Army has engaged in humanitarian assistance around the region. A Chinese economic "hard landing" would reduce not only prospects for Chinese economic engagement

Much of China's cooperation and cultural engagement in Latin America is intended to curry favor in the region's resource-rich countries.

but also China's military presence, educational initiatives, media-related efforts, and cultural activities in the region. Much of China's cooperation and cultural engagement in Latin America is intended to curry favor in the region's resource-rich countries. Work toward this end is much less necessary in the face of declining demand for raw materials.

A second, much more optimistic, scenario envisions China-Latin America relations progressing much as they have over the past decade, with engagement based predominantly on existing trade complementarities. This scenario assumes continued high rates of economic growth in China and corresponding high levels of demand for raw materials and agricultural commodities. It is based on an assumption that China's demand for non-agricultural commodities will remain high, spurred on by resource-intensive infrastructure, the industrial sector, and affordable housing programs specified in China's 12th Five-Year Plan.

If implemented, these ambitious infrastructure projects will require sustained import of raw materials from around the globe. At current rates of consumption, China is self-sufficient in only five of the nineteen major minerals. And imports of iron ore, crude oil, and copper now account for more than 20 percent of the country's total imports. In 2011, China's petroleum and iron ore imports were as high as 63.14 million tons and 177.17 million tons, respectively; that represents increases of 11.4 percent and 14.3 percent over the previous year. Goldman Sachs has adopted a bullish outlook for both China and industrial commodities based on China's massive urbanization efforts and Beijing's continued focus on affordable housing construction. Others see China's surge in social financing over the second half of 2012 as promoting continued resource-intensive domestic investment.

Sustained demand and high commodity prices would likely prolong the China-related economic boom in parts of Latin America. They might also encourage deeper economic collaboration and expanded political, social, and educational cooperation. In many cases, bilateral educational, cultural, scientific, and technical cooperation have accompanied China's deepening economic engagement with the region. But preservation of the existing composition of trade between China and Latin America—in which Latin America exports mostly commodities and imports manufactured goods—would present ongoing challenges for Latin American policymakers. Concerns in the region about de-industrialization, export "primarization" (export of higher proportions of primary goods), environmental degradation, and insufficient technology spillover have all accompanied China's growing engagement over the past decade. These concerns will persist so long as China's economic activity is perceived to be resource-driven and focused predominantly on the region's primary sectors.

A third scenario, and one that is favored by most economists and major financial institutions, assumes a slight decrease in China's GDP growth in the coming years as China promotes consumption-driven economic growth over its current investment-heavy model. Slowing of this nature comes as no surprise; it is already taking place to a certain extent. Premier Wen Jiabao alerted the Chinese public to the prospect of slowing growth nearly two years ago in his 2011 Government Work Report. The 2012 Government Work Report announced a further decline in growth to 7.5 percent over the course of this year, and predicted

an average of 7 percent growth between 2011 and 2016. Growth in the 7 percent range is more "sustainable" than previous record rates, according to China's leaders.

By most all accounts, a near 1 percent decline in China's GDP growth rate over the course of the year still implies fairly high rates of demand for certain Latin American commodities, albeit at lower levels than in previous years. This is especially the case with agricultural commodities. Despite a nationwide focus on improving agricultural intensity, China's production capacity remains limited. Desertification and environmental degradation further threaten the country's food security. Toxic chemicals have contaminated as much as 10 percent of farmland, according to some estimates. As a result, at current levels of demand, China will soon import 13 percent of its agricultural goods. This bodes well for Latin America's agricultural giants, some of which already are doing a commendable job of promoting their agricultural exports in the Chinese market. In 2011, Argentina negotiated protocols with China for the export of meat, corn, limes, peas, and apples. Ecuador reportedly signed an agreement in 2011 to export 3,000 tons of cocoa to China. Chile, Colombia, Jamaica, and others are also looking to expand agricultural exports to China.

China's recent slowdown from its 8.9 percent annualized growth rate has yet to lead to a reduction in purchases, according to Brazilian officials. There are some indications, however, that slowing Chinese growth is already affecting demand for and prices of construction-related commodities and equipment. China's curb on property sales and plans to shift the economy toward a consumption-driven model have been associated with a 20 percent decrease in iron-ore prices between 2011 and 2012. Australian firms predicted a drop of 8.5 percent in iron ore prices over 2012 as growth in Asian steel production weakened.

Facing uncertainty at home, China is reevaluating its economic involvement in the region, especially its high-risk engagement.

The economic relationship between China and Latin America is rather established at this point. Latin America will continue to look to Asia and elsewhere to diversify its economic partnerships. Of interest, though, is whether a slight dampening of Chinese trade and investment will encourage more pronounced anti-China sentiment in the region. The economic benefits of engagement with China have justified deals with the Asian giant even in the face of public opposition. Certain political parties and interest groups in Mexico, Brazil, Venezuela, Ecuador, and much of the Caribbean have expressed concerns about China's effect on their countries' long-term economic well-being. Criticism of China was especially evident in the lead-up to recent Venezuelan and Ecuadoran presidential elections. These arguments could hold more weight if the impact of slowing growth in China becomes increasingly apparent. Anti-China sentiment might also increase in the event of rapid expansion of Chinese trade and investment. But although China's broad-based urbanization efforts are likely to sustain demand for Latin America's raw materials for the time being, decelerating Chinese growth in coming years would indicate a leveling, and not a rapid expansion, of economic engagement in Latin America.

Criticism of the relationship is not unique to Latin America. Facing an uncertain economic environment at home, China is reevaluating its economic involvement in the region, especially its high-risk engagement. Its preferred status in Venezuela won't be guaranteed in a post-Chávez political environment. And the $36 billion in loan agreements negotiated between Chávez and China's policy banks

will face scrutiny in the coming years. Even commodities-backed loans—the China Development Bank's preferred lending mechanism—may prove overly risky in Venezuela, where the political situation is precarious at best.

Latin America's Diverse China Policy

It is fair to say that Latin America's short- and mid-term economic prosperity is tied—for better or worse—to China's economic growth prospects. For certain Latin American countries and sectors, fluctuations in Chinese demand could mean the difference between continued high rates of growth and economic misfortune. This is especially the case for Latin American metals exporters, which are most susceptible to demand fluctuations. Concerns about slowing Chinese growth (as well China's effects on the environment, labor standards, industry, and domestic institutions) have led to a wide variety of policy responses across the region over the past decade.

Latin American countries derive varying degrees of economic benefit from Chinese engagement. As a result, China-related policies differ from country to country. For example, Mexico and Central America benefit significantly less from trade with China than their South American counterparts. Mexico has an 11:1 trade deficit with China; most of the region's commodities exporters maintain a surplus. Mexico's relationship with China over the past decade has not been one of immediate "mutual benefit" or of ease, necessarily.

Though increasingly reliant upon commodities exports and high commodity prices for economic growth, Chile, Peru, and Colombia, in particular, are making respectable progress toward deepening economic cooperation with China and Asia more broadly. Peru, Chile, Colombia, and Mexico signed the Pacific Alliance agreement in April 2011 to boost economic and trade linkages with the Pacific region. The sixth in a series of China-Latin America Business Summits was held in Hangzhou in October 2012 to create linkages among nearly 1,000 Chinese and Latin American firms. Recognizing the transformative effect of Chinese trade, Costa Rica initiated and later enacted a free trade agreement (FTA) with China. Peru and Chile have done the same. Colombia is now in the process of conducting its own feasibility study for an FTA with China. And Chile is presently negotiating an FTA with Hong Kong. If signed, it will be Hong Kong's first with a Latin American nation. Outward-oriented policies should position these countries to reap the benefits of enhanced trade, FDI, and financial integration.

Argentina and Brazil have embraced protectionist measures in response to Chinese manufacturing sector competition.

The region's policy responses are also informed by complex domestic and sub-regional political dynamics. Venezuela, Ecuador, Cuba, and, to a lesser extent, Bolivia look to China (as well as to one another) for aid, finance, and even consultation on macroeconomic policy and financial matters. Ecuador and Peru face substantial resistance to Chinese mining activity from their indigenous populations. And Brazil's labor-friendly government is alternately welcoming of Chinese engagement and beholden to industrial special interests. In economic terms, regional responses have ranged widely, from expanding trade liberalization to full-fledged protectionism—with everything in between.

Argentina and Brazil, most notably, have embraced decidedly protectionist measures in response to Chinese manufacturing sector competition. While unable to impose direct tariffs due to its Mercosur affiliation, Argentina's government has implemented a series of policies over the past few years to restrict foreign imports. This

action is leading to higher costs for consumers and taxpayers. Both Argentina and Brazil have proposed caps on foreign landholdings, largely in response to booming soybean production and growing Chinese interest in overseas land purchases. Following a 35 percent surge in Chinese imports in 2011, Brazil's President Dilma Rousseff initiated a series of preferential tax policies for domestic producers as part of the "Plano Brasil Maior" industrial policy. The country's September 2011 tax on imported vehicles generated concern at the World Trade Organization (WTO), which has noted a global trend toward protectionism in the aftermath of the financial crisis. The Chinese have expressed concern about protectionist trends in recent academic publications and policy documents.

China also remains a top target of antidumping authorities in Argentina, Brazil, and Mexico, which emphasize trade imbalances brought about by an undervalued Chinese currency. Following termination in 2011 of trade barriers protecting Mexican enterprises from low-priced Chinese goods, the Mexican government vowed to continue fighting unfair Chinese trade practices in the WTO. The relationship is such that China has come to expect retaliation against certain manufactured exports. Its 12th Five-Year Plan identifies a growing need for mutually beneficial "win-win" trade relations to avoid protectionist measures.

For yet another set of countries, China assumes a role of last-resort financier. According to a report published in 2012 by the Inter-American Dialogue, China has provided approximately $75 billion in loan commitments to Latin American countries since 2005, with the vast majority going to Venezuela, Ecuador, Argentina, and Brazil. Commodities-backed loans have financed large-scale infrastructure and social projects in Venezuela and Ecuador, in particular. However, weak institutions and questionable macroeconomic policy in these countries will prevent longer-term gains from Chinese lending.

> Chinese demand enabled Latin America to emerge from the global economic crisis relatively unscathed.

While Latin American countries have adopted a wide range of responses to China's growing presence, few are implementing the sort of structural, competitiveness-enhancing measures so often prescribed for long-term economic prosperity. Persistent demand for commodities exports coupled with soaring commodities prices has enabled certain countries to achieve high rates of growth without the need for painful competitiveness-enhancing reforms. In the absence of (often politically unpopular) structural change, however, the region's long-term growth prospects aren't especially promising. Latin America's manufacturers have been dealt a severe blow, and commodity-centered development is not optimal in the long run—even with sustained demand. Furthermore, the region's new trade linkages still assume considerable export of raw materials and agricultural goods. Expansion of trade based on primary commodities will promote continued high rates of growth only in a best-case global economic scenario—one in which the Eurozone muddles through, the United States continues its slow economic recovery, China grows at relatively high rates, and demand for Latin America's exports remains high.

If Latin American nations are planning at all with respect to China, they are not anticipating a worst-case scenario. The expectation, instead, appears to be more of the same in terms of trade and economic demand from China—even though most bets are on further slowing and fluctuations in demand as China prepares to overhaul its economic growth model. Referencing severe air pollution in China's northeast, even the strongly pro-Party *Global Times* urged China to reevaluate its growth model. Without rebalancing and reforms, as Morgan

Stanley's Stephen Roach recently argued, the days of the automatic Chinese soft landing may be over. China's future economic development will depend in large part on the leadership's ability to implement much needed economic and institutional reform in the coming years.

Latin America will not be able to depend on China in the event of another economic crisis—especially if China's slowing growth is the culprit.

Chinese demand enabled Latin America—and the region's commodities exporters, in particular—to emerge from the global economic crisis relatively unscathed. Latin America will not be able to depend on China in the event of another economic crisis, however—especially if China's slowing growth is the culprit. Furthermore, despite promotion of "mutually beneficial" and "win-win" policy in most all of its overseas dealings, China's motivations for engaging the region—whether in terms of trade, investment, culturally, or otherwise—are firmly linked to its own domestic interests. The very premise of China's "going-out" strategy (the country's policy for firm-led overseas engagement) is to realize China's long-term economic and social development. China's global engagement remains driven by its leaders' plans for domestic development as prescribed in its 12th Five-Year Plan and 18th Party Congress foreign policy pronouncements.

Looking ahead, most would anticipate further expansion of China-Latin America relations. China has begun working with the Inter-American Development Bank and through regional organizations like ECLAC and the Community of Latin American and Caribbean States (CELAC) to develop stronger partnerships and more balanced relations with the region. This is a positive step and evidence of China's commitment to a long-term presence in Latin America. But the onus is on regional leaders to establish favorable agreements with China and to seize upon current high rates of growth to develop a robust long-term growth agenda. By most accounts, continued progress will require implementation of difficult structural reforms and competitiveness-enhancing measures. While Chinese growth may very well hover in the 7 to 8 percent range for years to come, it would be prudent to plan for a less rosy scenario.

Comment by Alejandro Izquierdo

Margaret Myers does a very good job in presenting possible scenarios for China's economic future while trying to assess their likelihood, their potential effect on Latin American countries, and their impact on China-Latin America relations. As Myers acknowledges, growth in Latin America to a large extent was due to favorable external factors, one of them being quite positive terms of trade.[1] A substantial share of Latin America's expansion came from growth in commodity prices, pushed up by rising demand from China as foreign direct investment and purchasing power increased.

A question lingers in Myers' work: Will this trend continue? The answer is not straightforward. Much of the increase in Chinese consumption is related to greater purchasing power that, in turn, can be explained by the widespread shift of workers from relatively unproductive agricultural jobs to more productive coastal-urban jobs. In 1990 only 2.6 of every ten individuals lived in urban areas; today roughly five out of ten do.[2] This trend will most likely continue, although agricultural workers will be temporarily absorbed at a slower rate, the result of the lack of growth by large trading partners such as the United States and Europe, which accounted for close to 40 percent of trade before the recent global economic crisis. China's ratio of rural-to-urban dwellers is still high when compared to large but richer economies like the United States, where the urban-to-rural ratio is eight out of ten. Therefore, even with the slowdown, there is room for China to further absorb workers into urban areas—with subsequent increases in productivity and demand. This trend pushes in favor of Chinese growth.

Despite this long-run trend, China's recent slowdown has had an impact on several commodity prices. Agricultural and raw materials fell 12.6 percent in 2012, metals were also down by 18.6 percent, and iron ore prices dropped a notable 23.4 percent. This apparently large sensitivity of commodity prices to Chinese growth is partly due to the lack of demand by industrial countries, many of which are now in recession or growing only slowly. However, this sensitivity may become more relevant as China and other BRIC countries assume a larger share of global trade because, as mentioned in a recent Inter-American Development Bank report, imports in BRIC countries have a larger commodity component (25 percent of total imports) relative to those of industrial countries (15 percent of total imports).[3]

Could China's recent slowdown turn into very low growth? This doesn't seem the most likely scenario. In addition to the long-run trend mentioned above, so far the Chinese government has successfully coped with international shocks. Even during the global crisis of 2008-2009, private consumption stayed above its pre-crisis trend. This occurred mainly as a result of policies geared toward increased government investment, leaving domestic consumption trends pretty much intact at a time of global despair. This does not mean that there are no threats. Many will argue that skeletons remain in the domestic banking system, in part because of potentially bad loans to public enterprises and government agencies. And international reserves, which could be used to support the banking system, accounted for more than 55 percent of credit to the private sector in 2008, but are now down to 33 percent.

What should Latin America expect as a result of China's recent slowdown? One clear message is that the region should not rely on

[1] Research supporting this statement can be found in "Booms and Busts in Latin America: The Role of External Factors," by E. Talvi, A. Izquierdo, and R. Romero, IDB Working Paper 631, (2008).

[2] Source: World Development Indicators database, World Bank.

[3] See IDB annual macroeconomic report "One Region, Two Speeds: Challenges of the New Global Economic Order for Latin America and the Caribbean," March 2011.

forever-increasing commodity prices to generate growth. Latin America's commodity exports may remain high—most likely as a result of the structural changes underway as China and other Asian economies participate more actively in global demand—but the upward push in commodity prices is likely to wane for a while, and incentives to growth stemming from this source are likely to decline.

Has the recent commodity bonanza worked for everybody? As Myers clearly states, Mexico and Central America—mostly net commodity importers—have benefited less from trade than countries in commodity-exporting South America.[4] In fact, the former group has experienced declining terms of trade on average. But it is not all bad news for this group. China's prosperity has been accompanied by rising wages in coastal areas, a factor playing against Chinese competitiveness. Consider the case of Mexico. According to JP Morgan, the ratio of Mexican-to-Chinese salaries was about 4-to-1 in 2001—making it difficult for Mexican firms to compete against their Chinese counterparts. The ratio has now narrowed to only 1.2-to-1. This, coupled with proximity to the United States, makes Mexican industry look much more competitive in the eyes of international investors.

How should Latin America approach Chinese expansion and the region's commodity-export-led growth? Myers ascertains that soaring commodity prices have enabled certain countries to achieve high rates of growth without the need for painful competitiveness-enhancing reforms and that a robust long-term growth agenda should be developed. Does this mean that commodity exports should be discouraged? Quite the contrary. They should be part of a larger growth agenda that embraces this expansion while recognizing that commodity exports on their own are unlikely to generate sustained growth.

This brings me to the next question: What should Latin America do—in terms of policies—with the proceeds from the commodity-price bonanza? To begin with, large upswings in commodity prices may very well bring Dutch disease effects, making non-tradable goods more expensive, raising production costs, and eroding competitiveness. It was clear when the boom started—and even clearer now—that resources derived from the commodity price bonanza should be invested in areas that will make the region more productive. Governments will need to think about policies such as facilitating investment in better roads and port infrastructure—for example, by promoting public-private partnerships—or that support R&D activities leading to innovation and increases in total factor productivity. They also need to think about working on frameworks that will promote reallocation of workers from small, informal, and less productive firms into large, formal, and more productive firms.[5] As indicated in a recent World Bank report, in contrast to the Japanese expansion that led to the Japan-Tigers connection, there is little evidence so far that China is fostering productivity growth in the region as Japan did for the East Asian economies in the past. That means Latin America will need to work harder on raising productivity by means other than the China-Latin America connection.[6]

[4] See IDB annual macroeconomic report "One Region, Two Speeds: Challenges of the New Global Economic Order for Latin America and the Caribbean," March 2011.

[5] See "The Age of Productivity," IDB Dialogue in the Americas (2010) for a discussion on worker allocation.

[6] See "Latin America's Growth Prospects: Made in China?" World Bank LAC Report, September 2011.

Comment by Barbara Kotschwar

Margaret Myers' excellent paper "China and Latin America: What Lies Ahead" provides an informative overview of the China-Latin America dynamic, grounding this relationship in historical perspective and offering three reasonable lenses through which to view the future. All of these lenses underscore a main message about how vulnerable Latin America is to external factors.

Myers' first scenario, her doomsday case, has China's growth slowing dramatically, with the commensurate plunge of commodity prices on whose continued rise many Latin American economies have become so reliant. This scenario predicts a "hard landing" for China and, in response, a diminution in China-Latin America relations as China struggles with scarcity. This scenario has worrying implications for Latin American growth. This scenario is cautionary enough, even without explicitly taking into account the impact that such a slowdown of the global growth engine will have on the rest of the world. Should China's growth slacken significantly, world growth will be pulled down as well, affecting other major Latin American trade partners and doubly impacting Latin America. Given that their own growth will also be affected, trading partners such as the United States, the European Union, or large emerging economies would be unlikely to step into China's place.

Myers' "halcyon" scenario—projected by the status quo—links Latin America's economic fortune to continued high growth in China, continued high commodity prices, and a continuing reliance on China. All is not milk and honey in this scenario, however. While Myers highlights the positives, including continued and ramped up cooperation, particularly educational, social, cultural, scientific, and technical, negatives abound. In this world, debate will continue around whether China is "locking up" the world's natural resource base to the detriment of non-Chinese users and consumers around the globe. This scenario would guarantee continued discussion—likely with supporting evidence on both sides of the argument—about whether China is perpetuating a new era of resource curse outcomes, with diversion of revenues to corrupt elites, poor labor and environmental practices, and marginalization of local populations in regions with oil or minerals. It also would have implications for global climate change discussions. China's enhanced economic activity, much of it based on Latin American resources, will have a significant impact on the environment. How much will Latin American countries be pressured to side with their trading partner in subsequent climate talks?

The third scenario, a much-tempered version of the doomsday scenario and Myers' most realistic one, incorporates cautions from the first two scenarios. An interesting point is the evolution of China's approach to Latin America. Now, after a decade of intense engagement, Myers implies that China is increasingly differentiating among Latin American countries, seeing some, like Venezuela, as too high risk. It will be interesting to see her follow this line of thought, to examine whether such differentiation will lead to customized treatment of countries and, if so, whether this will affect relations among Latin American countries.

A common theme in all three scenarios is Latin America's strong dependence on China. Myers' reference to Latin America's experience with Japan in the 1970s ad 1980s is instructive: At that time, fear of a natural resource curse and of predatory investment also abounded. What this paper underscores is the importance of external factors to Latin America's growth and development and the unpredictability that this brings to the region. Whether the main economic partner is the United States or Japan or China, the region's policymakers

should be wary, keeping a close eye on rainy day measures in the event that economic partners fall upon hard times or shift attention elsewhere.

Myers has set herself—and her colleagues at the Dialogue—a robust research agenda, one that I look forward to following. What happens as China plays an increasingly influential role in world policies? Will Brazil, potentially emboldened by new oil wealth and already starting to take on China in matters of currency, expand its challenger role? What is the best way to engage China? Do countries that enter into formal institutional agreements (as of this writing three have entered into free trade agreements with China) have greater certainty and predictability in their relationship than countries such as Brazil, which rely more on less formal or case-by-case (such as commodity financing) arrangements? Countries such as those in the Pacific Alliance are making a concerted effort to smooth out the bumps in their trade relations by harmonizing common provisions, cumulating rules of origin where possible, and signing common FTAs. In contrast, MERCOSUR members have fewer links to Asia. What is the impact of the current bifurcation in economic orientation between the Pacific-oriented countries and the MERCOSUR countries?

> China's enhanced economic activity, much of it based on Latin American resources, will have a significant impact on the environment.

Finally, I welcome Myers' call to Latin American policymakers to address their competitiveness and productivity challenges, particularly as they deepen their relations with Asian countries and their integration into the international system. This seems key under any of the three scenarios.

The Politics of Latin America's New Middle Class

BY FRANCIS FUKUYAMA

Perhaps no development portends positive political change as much as the growth of the middle class across a range of countries in Latin America. This phenomenon of the past decade is closely related to another trend, the notable decline of income inequality for the region as a whole.

The political implications of a growing middle class are potentially enormous. Latin America, as is well known, has been the most unequal part of the world when it comes to income distribution. The gap between elites and poor people has fed polarized politics and instability ever since independence in the early 19th century. At one time this manifested itself as a fight that pitted Marxist and other extreme-left groups against anti-communist conservatives. Today, it is a struggle between populist politicians pursuing unsustainable redistributive policies and mainstream democratic parties, many of which fail to connect with the poor.

The rise of a strong middle class in Latin America points to a way out of this polarization. If the median voter is no longer a poor person but an individual with assets and education, rather than upending the system he or she will, presumably, have a greater stake in sound public policies to preserve the value of those assets and protect his or her social position. This promises the emergence of a political atmosphere more typical of the developed world, with contestation between center-left and center-right political parties that differ on the degree and forms of redistribution but are fundamentally committed to liberal democracy and economic growth driven by market forces.

This kind of society and politics has already begun to emerge in countries like Chile, Brazil, Colombia, and Mexico. However, while the shift in Latin America's social structure has been encouraging, it is too early to count these gains as permanent. Even if a strong middle class does emerge, the impact on politics could, under conditions of economic reversal, be that much more destabilizing. Nonetheless, we need public policies that encourage the growth of this segment of the population.

The Global Middle Class

Substantial writing in the past decade has examined the arrival and prospects of a new global middle class that will shape the world economy and politics over the next two generations. A Goldman Sachs report projects that spending by the world's middle three income quintiles will rise from the current 31 percent of total income to 57 percent in 2050.[1] Research by the European Union Institute for Security Studies estimates that the middle class population will grow from 1.8 billion in 2009 to 3.2 billion by 2020 and to 4.9 billion in 2030 (out of a projected global

[1] Dominic Wilson and Raluca Dragusanu, *The Expanding Middle: The Exploding World Middle Class and Falling Global Inequality* (Goldman Sachs Global Economics Paper No. 170, 2008), p. 4.

> If the median voter is no longer a poor person but an individual with assets and education, she will have a greater stake in sound policies to preserve the value of those assets.

population of 8.3 billion).[2] The bulk of the growth is slated to occur in Asia, particularly China and India, but all regions of the world—including Latin America—will participate in this trend.

Many countries in Latin America reached middle- or even upper-middle-income status well before their Asian counterparts. Nonetheless, they have registered additional gains. In 2002, 44 percent of the region's population was classified as poor; by 2010, this figure had fallen to 32 percent, according to the United Nation's Economic Commission for Latin America and the Caribbean (ECLAC).[3] This shift is particularly notable in Brazil, where many observers have pointed to the emergence of a new middle class with significantly higher levels of personal consumption. (The performance of individual Latin American countries varies widely in this regard, however.) Nora Lustig and her colleagues have documented an impressive fall in income inequality, as measured by Gini coefficients, across much of Latin America in the last decade—following a prolonged period when inequality was on the rise.[4]

Who Is Middle Class?

Before we accept these findings as gospel, however, we need to define what is meant by "middle class." There is a sharp distinction in the way that economists and sociologists think about the term. The former tend to define middle class in simple income terms. A typical way is to choose some band of income distribution, such as the middle one to three quintiles, or alternatively 0.5 to 1.5 times the median income. This makes the definition of middle class dependent on a society's wealth and, thus, incomparable cross-nationally; being middle class in Brazil means a much lower consumption level than in the United States.

To get past this problem, some economists choose an absolute level of consumption, ranging from a low of US$5 a day, or $1,800 in annual purchasing power parity (PPP), up to an income range of US$6,000 to US$30,000 per year. This fixes one problem but creates another since an individual's perception of class status is often relative rather than absolute. As Adam Smith noted in the *Wealth of Nations,* a pauper in 18th century England might live like a king in Africa.

Using income definitions produces different estimates for the size of the Latin American middle class. If using an absolute measure of US$2 to US$20 per day PPP for a selected group of countries, the results range from 55 percent (Argentina) to 77 percent (Peru) of the total population being middle class, according to estimates by the Organisation for Economic Co-operation and Development (OECD). Using a median income definition produces lower numbers, from 36 percent (Bolivia) to 50 percent (Mexico).[5] Another OECD estimate places Latin America's middle class at 181 million, or 10 percent of the global middle class population.[6]

[2] European Union Institute for Security Studies, *Global Trends 2030: Citizens in an Interconnected and Polycentric World* (Paris, 2012), p. 28.

[3] This figure is quoted in Francesca Castellani and Gwenn Parent, *Being "Middle Class" in Latin America* (OECD Development Centre, Working Paper No. 305, October 2011), p. 9.

[4] Nora Lustig and Luis Felipe Lopez-Calva, *Declining Inequality in Latin America: A Decade of Progress?* (Washington, DC: Brookings Institution Press, 2010).

[5] OECD (2011), p. 11.

[6] Homi Kharas, *The Emerging Middle Class in Developing Countries* (Paris: OECD Development Centre, Working Paper 285, Jan. 2010), p. 16.

Sociologists, in a tradition beginning with Karl Marx, tend not to look at statistical measures of income but, rather, at how one's income is earned, occupational status, level of education, and assets. Marx's original definition of bourgeoisie referred to ownership of the means of production. One of the characteristics of the modern world is that the ownership of capital has become vastly democratized through pension plans. Even if one does not own large amounts of capital, employment in a managerial capacity or in a profession often grants a different social status and outlook than a wage earner or low-skill worker might hold.

My preferred definition is the sociological one since I am interested here primarily in the *political* implications of a growing middle class. Simple measures of income or consumption, whether relative or absolute, tell you relatively little about the political inclinations of the person in question. One of the longstanding theories of political science, stated most forcefully by Samuel Huntington in his book *Political Order in Changing Societies*, is that instability is driven by a gap between expectations and reality with regard to both political participation and job opportunities.[7] By this theory, a poor person of low social status and education who rises out of poverty and then sinks back is less politically destabilizing that a middle class person—someone, say, with a university education—who cannot find a job and "sinks" into a level of consumption, even if that level is significantly higher than that of a former poor person who is supposedly middle class. From a political standpoint, the most revealing marker of middle class status would then be ownership of assets (a house or apartment and consumer durables), which could be taken away by the government, and education level.

If one uses education as an indicator, the size of the middle class shrinks in a dramatic fashion. Table 1 shows educational attainment levels of the "middle class" measured by income in Argentina, Brazil, and Chile. In Argentina, less than 18 percent of the middle class has a high school education; in Brazil, less than 2 percent are college educated.

Table 1: Middle Class Education Levels*

	Argentina	Brazil	Chile
Primary completed	34.7	52.1	17.4
Secondary completed	17.9	23.2	24.5
Tertiary completed	6.6	1.9	5.4

* OECD (2011), p. 22.

Table 2 shows the occupational structure of those designated "middle class" by income characteristics. Together, these tables suggest that the middle class revolution in Latin America is perhaps a bit less impressive than at first glance. One large occupational group, from 30-50 percent depending on country, are what in Europe would be designated as "working class" in manufacturing, construction, or transport. Reflecting the region's poor performance in education, no more than 20 percent in any country could be considered professionals (many probably being teachers). Many of the rest are former poor—owners of small shops or restaurants—and workers in the informal sector who have increased their incomes due to general economic growth.

The Middle Class and Politics

There has been a great deal of theorizing as to why the existence of a middle class is important, both economically and politically. William Easterly has linked what he labels a "Middle Class Consensus" to higher economic growth, education, health, stability, and other positive outcomes.[8] Economically, the middle class is theorized to have "bourgeois" values of self-discipline, hard

[7] Samuel P. Huntington, *Political Order in Changing Societies, with a New Forward by Francis Fukuyama* (New Haven, CT: Yale University Press, 2006).

[8] William Easterly, *The Middle Class Consensus* (World Bank, July 2001).

Table 2: Middle Class Occupations*

	Argentina	Uruguay	Brazil	Chile	Costa Rica	Mexico	Peru
Agriculture	4.0	1.1	19.5	16.5	18.4	12.7	32.6
Mining Water Elec	11.5	4.8	NA	2.6	1.7	1.0	1.5
Manufacturing	26.6	16.8	16.3	15.0	14.2	17.4	9.9
Construction, Transp	5.8	17.0	18.0	22.8	18.1	20.9	16.4
Wholesale hotels rest	16.7	21.8	21.0	16.2	22.5	22.6	23.8
Public Edu Health	18.5	20.5	9.2	11.2	9.3	9.3	8.7
Other services	16.9	17.9	16.1	15.7	15.8	16.1	7.1

* OECD (2011), p. 23.

work, and a longer-term perspective that encourages savings and investment.[9] Many analysts trace this view to Max Weber, whose famous work *The Protestant Ethic and the Spirit of Capitalism* inserted a values-based variable into the explanation for economic growth.

Unfortunately, many of these observers misunderstand Weber. Bourgeois values by his account are not endogenous to growth; rather, they are due to totally exogenous factors like the rise of Puritanism in 16th century Europe.[10] A poor person may hit a certain income level due to thrift and hard work, but she may also hit it due to a rising tide that is lifting all boats. Social habits may not change just because one has become richer. There is considerable evidence that the increase in consumption by the former poor in Brazil has been fueled by an unsustainable increase in available credit. As in the United States during the boom of the 2000s, this has not produced classic bourgeois values but, rather, the opposite: a decrease in the propensity to save and a sense of entitlement to ever-increasing levels of consumer spending. The resilience of such people to economic shocks would presumably be different than for an abstemious Weberian-style bourgeois.[11]

My main concern here, however, is the impact of a growing middle class on politics. There are several channels by which a middle class theoretically can impact the performance of political systems. As noted earlier, a strong middle class with some property and some education is more likely to believe in the need for both property rights and democratic accountability. This is not a cultural issue but a matter of self-interest: One wants to protect the value of one's assets from rapacious or incompetent governments and is more likely to have time to participate in politics (or to demand the right to participate) because higher income provides a better margin for family survival.

This view is a bit more than a theory. A number of cross-national studies, including a series of recent Pew surveys, have shown that middle class people have different political values than the poor. They value democracy more, want more individual

[9] See Luis F. Lopez-Calva, Jamele Rigolini, and Florencia Torche, *Is There Such a Thing as Middle-Class Values? Class Differences, Values, and Political Orientations in Latin America* (Washington, DC: Center for Global Development, Working Paper 286, Jan. 2012.)

[10] There has in fact been an exogenous religious movement in Latin America with the conversion of Catholics to evangelical Protestantism, with a number of scholars noting that this process has indeed yielded the kind of improved social indicators that Weber's theory predicts. The degree to which this constitutes a durable phenomenon requires further study. See David Martin, T*ongues of Fire. The Explosion of Protestantism in Latin America* (Oxford: Basil Blackwell, 1990); David Stoll, *Is Latin America Turning Protestant? The Politics of Evangelical Growth* (Berkeley, CA: University of California Press, 1990).

[11] Patricia Mota Guedes and Nilson Vieira Oliveira, *Democratization of Consumption* (Brauder Papers 02, 2006).

freedom, are more tolerant of alternative lifestyles, etc.[12]

By contrast, countries with large numbers of poor or marginalized voters and small elites have tended to produce populist politics. The rise of Hugo Chávez, Evo Morales, and Rafael Correa in the countries in ALBA (the Bolivarian Alliance for the Peoples of Our America) is less the cause of instability than a symptom of deep inequalities in those societies and the failure of their erstwhile democratic parties to develop programs with relevance for the poor. Between 1996 and 2003, Argentina's middle class shrank by about 20 percent. While I cannot prove causality, this surely must have had some effect on the Peronist Party's shift from neo-liberal policies in the early 1990s to populist ones in the late 2000s.[13]

A new factor in the last decade has been the rise of the Internet and social media, which have been taken up much more readily by the middle class than by the poor. Improved communications technology does not necessarily imply a particular form of politics and it can be controlled or used by authoritarian governments. Still, access to information has been greatly democratized over the past generation, and the overall impact (as in the case of the Arab Spring) has been beneficial for democratic values.

Apart from abstract support for democracy, the rise of a middle class should also provide social support for an end to clientelistic politics and anti-corruption. Clientelism can be seen as an efficient form of political mobilization in countries with relatively poor and less educated populations. It became widespread in the United States beginning in the 1820s as the franchise was broadened.[14] The United States ended the patronage system during the Progressive Era at both national and municipal levels due to the rise of middle class groups whose interests were hurt by this kind of politics. Today, newly empowered middle-class entrepreneurs, professionals, and social reformers frequently spearhead anti-corruption efforts.

No group is more dangerous politically when its expectations are disappointed than the middle class.

A Double-edged Sword

While the rise of a middle class is generally good for liberal democracy, the link is by no means automatic, and in some cases middle class citizens may collaborate in the weakening or undermining of healthy political institutions. This was true in Latin America when the middle classes supported military takeovers during the 1960s and '70s.[15] Many observers have pointed to the fragility of Latin America's recent economic gains. Growth has been heavily driven by commodity exports to Asia, rather than indigenous industrialization. If the Chinese growth engine slows down, as it inevitably will, the Western Hemisphere will suffer as well. A global recession could have disastrous consequences for the former poor, particularly if their recent consumption levels were financed by debt rather than rising productivity.

No group is more dangerous politically when its expectations are disappointed than the middle class. Huntington pointed out that revolutions are almost never organized by the poor; rather they are instigated by middle class individuals who can't fit into the system. Even the most economically successful countries in the region like Chile or Brazil do not have a clear path to becoming

[12] Ronald Inglehart and Christian Welzel, *Modernization, Cultural Change, and Democracy: The Human Development Sequence* (New York: Cambridge University Press, 2005); *The Global Middle Class* (Washington, DC: Pew Global Attitudes Project, 2009).
[13] OECD (2011), p. 29.

[14] This is a topic that I will discuss further in the second volume of my book, *The Origins of Political Order.*
[15] See Guillermo O'Donnell, *Modernization and Bureaucratic Authoritarianism: Studies in South American Politics* (Berkeley, CA: University of California Press, 1973).

high income ones. Their existing employment bases are constantly threatened by new rising powers in Asia. A prolonged period of stagnation or economic decline may set off a new form of politics, perhaps unlike what we have seen. Greece today is a living laboratory for the political consequences of a country whose citizens are losing their middle class status.

In countries where the middle classes expanded and poverty declined, democracy has been the winner.

There are other ways in which the middle class can become a liability rather than a benefit to a democratic political system. One's occupational status matters a great deal. In past generations, a significant portion of the middle class in Latin America achieved that status through public employment, either in the public sector or in parastatals linked to the government. This type of middle class offers negative implications for democracy: employment is often clientelistic, public employees have a stake in a large state sector, the government—rather than private entrepreneurship—is seen as a road to wealth and status. Francisco Ferreira finds that some of the decline in Brazil's levels of inequality is due to the shift in middle-class employment away from the state sector.[16] If governments seek to make up for falling private sector employment through public sector expansion, we will be back to the old Latin America of the mid-20th century.

Moreover, the size of the middle class relative to the rest of the society matters. When the middle class constitutes a minority of the population, it oftentimes sides with elites against democracy because it fears that its wealth and status will be threatened if the poor have access to the political system. This happened in Thailand. While middle class Thais led the pro-democracy movement against the military in the early 1990s, they sided with the military against former Prime Minister Thaksin Shinawatra in the 2000s because they feared his brand of redistributionist populism would kill the Thai economic miracle. This has led to a sharp polarization of the country and a prolonged political crisis that is still unresolved. Something similar exists in China. The Chinese middle class is estimated at 300 million to 400 million people, or a quarter of the country's population. While it is hard to know their ultimate political preferences given the authoritarian political system, there is evidence that they, too, fear a rapid transition to democracy that would open up strong demands for redistribution on the part of China's rural poor. For a true middle class democratic consensus to emerge, this group needs to constitute a clear majority of the population so that redistributionist schemes do not threaten to derail all economic growth.

Conclusion

At this point in Latin America's history, it is difficult to conceive of the middle classes openly turning against democracy as they did in the 1960s and '70s. The post-dictatorship democratic consensus has held fairly strongly throughout the region, and middle class groups have shown little willingness to, for example, turn to the military to prevent the rise of populist politicians. So, in countries where the middle classes expanded and poverty declined, democracy has been the winner.

The bigger immediate challenge is whether middle class voters coalesce behind modern, programmatic political parties or are co-opted by clientelistic or personalistic parties that leverage their ability to distribute public resources and jobs to followers. The Partido Justicialista in Argentina or the PMDB in Brazil are examples. In the United States, economic modernization and

[16] Francisco H. G. Ferreira and Phillippe G. Leite, "Trade Liberalization, Employment Flows and Wage Inequality in Brazil," *Journal of Economic Literature,* 2006.

the rise of a new middle class signaled the end of clientelism and related forms of corruption. But in Greece and Italy, clientelism has survived despite high levels of economic development. Part of the reason that they, and the European Union as a whole, are in trouble today is because of the continuing role of clientelistic politics in their public sectors. There is no automatic mechanism that links a growing middle class to good government. Social groups have to be organized. And until political parties represent middle-class interests, they will have little effect on the political system.

Democracy in the region will not become fully institutionalized and stable until countries are governed by competitive center-left and center-right parties that offer different policies and programs but share a common commitment to liberal democratic values. And democracy will not be of high quality until it begins to revolve around issues and policies rather than personalities, jobs, and individual perks. The rise of a broad middle class does not guarantee either of these outcomes. But it is hard to envision a stable democracy or a non-clientelistic state emerging in the absence of this kind of a social base. In Chile and Brazil, the dominant center-left parties have eschewed populism and tried to formulate European-style social democratic agendas. In Colombia, middle class voters have brought to power new reformist mayors in Bogotá and Medellín and have supported the strengthening of the state required to resolve the country's internal conflicts. In Mexico, a rapidly growing middle class has blocked a turn to populism and may yet be mobilized to move past the country's clientelistic traditions. With continued economic growth, these positive trends should continue and Latin America's deep tradition of democracy will be more fully consolidated.

|| Democracy will not be of high quality until it begins to revolve around issues and policies rather than personalities, jobs, and individual perks. ||

Comment by

Michael Reid

Many of the numbers tracking the rise of a new middle class refer purely to disposable income. That is important. The numbers give the lie to the notion that everything is a disaster in Latin America. They are important for providing data for businesses about the growth of consumer markets. But they tell us little or nothing about political attitudes.

I agree that a sociological approach is much more useful, and it is a reality check, showing that the middle class is probably no more than a third of the population in the region. (That was the conclusion reached by the World Bank in a rigorous study, published after the Linowitz Forum, that defined the middle class in terms of economic security.[17])

While, as Fukuyama says, a strong middle class with some education and some property is more likely to believe in the need for both property rights and democratic accountability, he is surely also right to add that there is nothing automatic about the link between the growth of the middle class and the strength and quality of democracy. Argentina over the past fifty years provides a cautionary tale. It had become a predominantly middle-class society, but that middle class declined amid a vicious circle of erratic economic growth, fierce distributional conflicts, and mistaken policies.

So what are the prospects for a rapid expansion of Latin America's middle class in a sociological sense?

Take two of the attributes of the middle class: assets and education. After disappearing for a generation because of financial instability, mortgages are once again available in many Latin American countries. And there are low-cost government housing programs. This represent the beginnings of a "property-owning democracy" to borrow a phrase used both by British conservative leaders of the past century and by philosopher John Rawls.

Educational coverage is expanding very rapidly. In Brazil today, a 6-year-old can be expected to achieve twice as many years of education as his or her parents. Go to any self-built *barriada* in countries like Peru and Mexico and you will find the same story. The generation that migrated in the 1960s and 1970s had only a few years of primary schooling; their children or grandchildren, in their twenties today, will in most cases have completed secondary schooling and, in many cases, will have some technical or higher education.

Two caveats are in order. The quality of education in the region is improving, but from an abysmally low base. If you have been taught by a deeply ignorant *criollo* Maoist, as may well be the case in Peru, you won't automatically turn into John Stuart Mill. Second, and this is perhaps most doubtful, will Latin America's economies be able to provide jobs appropriate to the educational levels these young people are achieving? In other words, will there be enough middle class jobs? Latin America has far too many graduates working as taxi-drivers.

The New Middle Class

We know something about the political attitudes of the new middle class—and we can make guesses at others. The traditional middle class, still a presence in Argentina and Uruguay, worked in the public sector and had many statist attitudes. The new middle class is much more likely to be employed by the private sector. Many of its members are in the informal sector. The OECD found that in the typical Latin American country, around half the middle class does not contribute to a pension.

[17] "Economic Mobility and the Rise of the Latin American Middle Class," World Bank, November 2012.
The World Bank has the citation as: Francisco H.G. Ferreira, Julian Messina, Jamele Rigolini, Luis-Felipe López-Calva, Maria Ana Lugo, and Renos Vakis, "Economic Mobility and the Rise of the Latin American Middle Class," (Washington, DC: World Bank, 2013).

> The expansion of the new middle class offers hope of political progress, but it is still fragile and reversible.

The new middle class is also likely to seek private education and health services, both for aspirational reasons and as a silent rebellion against the poor quality of public provisions. Private schools are mushrooming in former *barriadas*. Most of the threefold increase in the numbers of Brazilians in higher education between 2000 and 2010 is explained by the expansion of private institutions. Much the same is true in Chile. The student movement in Chile is a demand for greater state provision, or facilitation, of education for all. It is likely to be matched elsewhere.

On the other hand, an expanding middle class reliance on private education and health care may make its members resistant to higher taxes. That could be a problem in Mexico or the Andean countries, but it could be an important check on statism in Brazil. (For those in the informal sector this may be a non-issue to the extent that they don't perceive the impact of the indirect taxes they pay.)

These issues serve as an example of how the new middle class is starting to put much more sophisticated demands on the state. It is no longer enough for political leaders to merely offer *una obra por ahí* or to control a price. In the 20th century, in different ways, countries such as Brazil, Mexico, Argentina, and Venezuela were state-dominated societies. In this century, thanks in large part to the expanding middle class, these societies are becoming much more dynamic, and that requires a rethink about the role of the state.

The political attitudes of many in the new middle class were formed when they were poor. Some seem to favor redistribution. For example, the new middle class in Brazil has been until now broadly *Lulista*. But others are what in Britain used to be known as working-class Tories. A Brookings study found hostility to welfare programs among the new middle class in Peru.

Unlike the traditional middle class, many members of the new middle class are mestizo or mulatto. To the extent that they face discrimination from the traditional middle class, they may be open to the appeal of populist leaders.

The expanding middle class has been a huge beneficiary of economic stability, so it would be logical to think it will be intolerant of higher inflation. But against that, middle class Latin Americans are debtors, rather than savers. They have benefited, too, from open economies and foreign investment.

The traditional middle class in Latin America has been, by turns, complicit in or intolerant of corruption. One would hope that an expanding middle class would spawn a kind of Progressive Movement favoring clean government, as in the United States a century ago. It doesn't help that the middle class in Latin America is expanding at a time when political parties and traditional forms of representation are in crisis worldwide. The new middle class is not organised, but it is as technologically connected as never before.

There are some signs of that in the formation of NGOs or online watchdogs monitoring public spending or in the popular mobilization behind the *Ficha Limpa* law (that bars congressional candidates with criminal records) or in the new student movement in Mexico. But this year, middle class votes may be decisive in giving power to the PRI.

In many ways, this is a subject with more questions than answers.

It is appropriate to conclude by citing Fernando Henrique Cardoso who, in the *A Soma e Resto* reflections published on his eightieth birthday last year, said: "The data show an increase in income,

the formation of new middle classes, but nobody really knows what is the political and social significance of this phenomenon." That may be a frustrating conclusion, but it is an honest and accurate one, and it shows that the new middle class calls for a vital field of study.

After a decade of commodity-fueled growth, Latin America is entering a new period in which raising productivity and encouraging innovation and competitiveness will be key to sustaining growth.

Will the new middle class act as a political constituency for reform? Or, as the commodity super-cycle draws to a close and growth slows, will middle class resentment provide further fuel for populism? That is perhaps the biggest political question in the region—and one for which it is hard to give a clear answer at the moment. My prediction would be that the expansion of the new middle class offers hope of political progress, but it is still fragile and reversible.

Social Trends in Latin America: Time to Move Beyond Growth?

BY GEORGE GRAY MOLINA[1]

Latin America is into its tenth year of sustained economic growth. Since 2002, poverty in Latin America and the Caribbean has dropped by about 58 million people, with 167 million remaining under the poverty line (equivalent to 29 percent of the population using national poverty lines, or 28 percent using the $US4/day international poverty line).[2] Inequality has also fallen in fourteen of seventeen countries, led by improvements in labor income and better educational returns at the bottom of the income distribution.[3] However, structural challenges hinder further progress. This is a good time to take stock of the growth-poverty linkages and ask what lessons can be learned.

An important question is whether further social gains can be expected from more economic growth. Most poverty and inequality reduction can be explained by rapid and sizeable increases in labor income, followed by the effect of public transfers, including conditional cash transfers (CCTs) or non-contributive pensions, and private transfers such as remittances.[4] The rapid rise in labor incomes tends to support the view that most achievements are growth-led. However, too little is known about how labor markets translate firm-level growth into broad-based income generation. Rather than trickle-down via good jobs in high-productivity sectors, recent growth is occurring in service sectors fueled by consumer demand. Does what is happening in the labor markets explain everything? Or are the long-run effects of educational and health policies or policy interventions in the labor market, such as formalization or minimum wage floors, also factors?[5]

The High-hanging Fruit of Latin American Progress

Recent labor income gains in Latin America concentrate in the service sectors, favoring male workers and largely bypassing youth employment. Labor income was also tempered cyclically, as labor shares improved during crises, and public transfers weighed most at the peak of the economic crisis in 2009. This pattern reveals interesting facts that run counter to the conventional wisdom.

First, rises in labor income account for an estimated 45 percent of the total poverty reduction

[1] George Gray Molina, United Nations Development Programme (UNDP), Regional Bureau for Latin American and the Caribbean. Email: george.gray.molina@undp.org. All opinions are personal, and do not reflect the institutional position of UNDP. Many thanks to Susana Martinez for permission to use research from Martinez, Susana and George Gray Molina, 2013, "The High Hanging Fruit of Latin America Progress," Human Development Research Brief 01/2013, New York, UNDP.

[2] World Bank, *On the Edge of Uncertainty: Poverty Reduction in Latin America and the Caribbean during the Great Recession and Beyond,* (Washington DC: World Bank, 2011); *Panorama Social de America Latina, Santiago*: CEPAL (2012).

[3] Luis Felipe Lopez-Calva and Nora Lustig (editors), 2010, *Declining Inequality in Latin America: A Decade of Progress?* (Washington, DC: Brookings Institution, 2010, and UNDP, 2009); Leonardo Gasparini and Nora Lustig, "The Rise and Fall of Income Inequality in Latin America," (La Plata: CEDLAS, 2011).

[4] World Bank, 2011, op. cit.

[5] Saúl N. Keifman and Roxana Maurizio, Changes in Labour Market Conditions and Policies: Their Impact on Wage Inequality during the Last Decade, (Helsinki: UNU-Wider, 2012).

Rises in labor income account for 45 percent of poverty reduction, followed by social transfers, pensions, and an increase in the number of working-age individuals.

effect, followed by social transfers (16 percent), pensions (10 percent), and an increase in the number of working-age individuals (9 percent).[6] Proportions vary. Brazil and Chile see more impact from transfers and pensions, and Mexico is more affected by labor income. Still, the overall figures are significant because they show that wages are rising in Latin America like they haven't for close to two decades.

Second, the growth patterns diverge from Chinese and Asian patterns. LAC economies are not expanding through improvements in manufacturing or upgrades in technology. In contrast to economies driven by strong manufacturing/export sectors that create jobs in non-tradeable sectors (transportation, logistics, processing, and export-oriented services), LAC jobs and wages seem to be growing on the basis of domestic consumption driven by commodity exports. Easy and available credit fueled consumer growth that made its way to construction and low-skilled services.

Third, if labor markets are tightening for low-skilled service-sector jobs, mostly aimed at males from 25 to 49 years old, future policy may need to focus on those excluded: youth, females, non-agricultural rural markets, and manufacturing and knowledge-intensive sectors. In the region's ongoing economic transformation, employees are leaving low-skilled, low productivity, and poorly paid jobs in agriculture or the manufacturing sector and moving to low-skill employment in retail trade and personal services, mostly in the informal sector (such as domestic service, street vendors, or beauty parlor owners).

With 167 million people still under the poverty line in Latin America and the Caribbean and 66 million under the indigence line,[7] there are still gains to be made from further growth in labor income and by expanding existing fiscal and social protection programs. Much of the remaining poverty, however, is concentrated in sectors and geographic areas that have either hit declining returns or are excluded from the dynamic sectors of the economy and/or existing social safety nets.

Two general trends are salient. First, labor participation and wages have increased since 1995, with males benefitting to a greater extent. Second, the share of labor participation in the service sector accounts for more than 60 percent of total employment and—with the exception of Peru—it has increased since 1995. The manufacturing sector and primary sectors have also shrunk since 1995. Manufacturing in Brazil and primary activities in Peru are the exceptions.

Microtrends that Point to New Challenges

Microtrends, group-specific trends that deviate from country averages, help describe the speed and direction of social and economic change. For example, increased access to education will, in the absence of technological upgrading, erode returns to education. Urbanization, which improved access to services in large cities in the past, will tend toward scale diseconomies. And the demographic dividend, which delivered a decline in labor dependency ratios, will eventually stretch labor markets and start to age.[8]

[6] Joao Pedro Azevedo, Gabriela Inchauste, and Vivian Sanfelice, "Decomposing the Decline in Income Inequality in Latin America," paper presented at the Network for Inequality and Poverty (NIP) Conference, April 2012, Columbia University, New York, NY.

[7] CEPAL, op cit., 2012.

[8] The term "microtrend" comes from Mark Penn, *Microtrends: The Small Forces Behind Tomorrow's Big Changes* (New York: Twelve, 2007), who constructs an insightful map and toolkit for grassroots political organizing.

Future policy may need to focus on the excluded: youth, females, non-agricultural rural markets, and manufacturing and knowledge-intensive sectors.

Disaggregating demographic, social, and labor data by age, geographic location, sex, ethnic group, and so on provides insight into existing and enduring disparities. And by pinpointing microtrends for certain groups, such as women in the formal labor market or youth entering the labor force for the first time, we are able to focus more tightly on hypotheses and mechanisms that might have a large impact over future trends (including human capital, skills premium, labor productivity, and wage shares). Microtrends also point toward future policy opportunities and challenges. If the past three decades were marked by urbanization, drops in the fertility rate, and increased access to education for females, the next decade is likely to be marked by now-incipient processes, among them increased global migration, climate change patterns, demographic shifts in household composition, adoption of communication technologies, crime and violence.

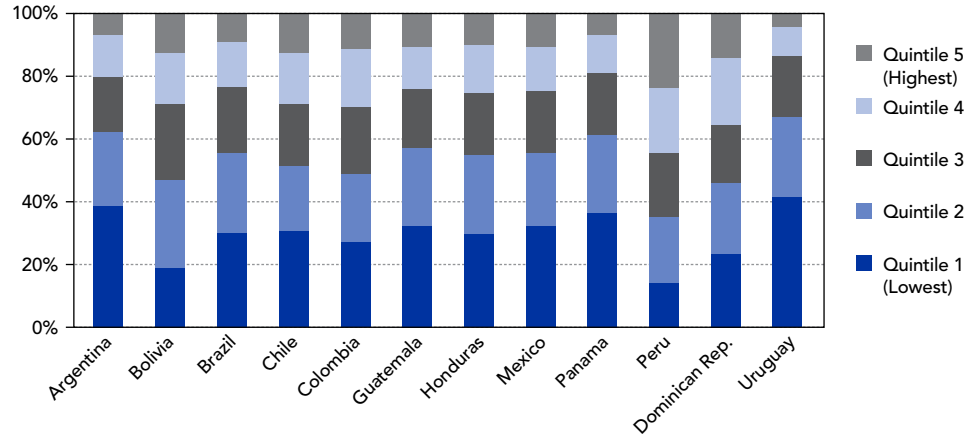
Idle youth, as labor markets are booming

One of the paradoxes of economic growth in Latin America is that, despite greater educational and labor opportunities, large numbers of young individuals neither study nor work. This is a phenomenon known as "idle youth"[9] or NINIs, referring to those that "ni estudian, ni trabajan." Currently, 18.5 percent of Latin Americans between the ages of 15 and 18—some 9.4 million people—neither work nor study. Interestingly, the highest rates in 2009 were in countries with very different economic and cultural trajectories: 28 percent in Honduras, 25.3 percent in Guatemala, 26.1 percent in Peru, 20.5 percent in Chile, and 20.4 percent in Colombia.[10] Figure 1 reveals that,

[9] World Bank, op. cit., 2011.

[10] M. Cardenas, R. de Hoyos, and M. Szekely, "Idle Youth in Latin America: A Persistent Problem in a Decade of Prosperity," in Latin America Initiative at Brookings (2011).

Figure 1. Idle Youth by Income Quintiles LAC12 (Age Group 15 to 18)



Note: Author's elaboration based on calculations using micro data from 214 household surveys (for the years 2007 and 2008) by Cardenas et al (2011).

> Despite greater educational and labor opportunities, large numbers (18.5 percent) of LA youth neither study nor work.

except for Peru, Bolivia, and the Dominican Republic, 50 to 60 percent of idle youth are concentrated in the lowest income quintiles.

Figure 2 provides a snapshot of Brazil, where there is increasing secondary school enrollment and decreasing youth employment. This suggests that greater educational opportunities are driving the young population out of the labor market. However, that unemployment has increased by 5 percent since 1995 suggests that although a lower percentage of young individuals are working, many are looking for jobs and not finding them.

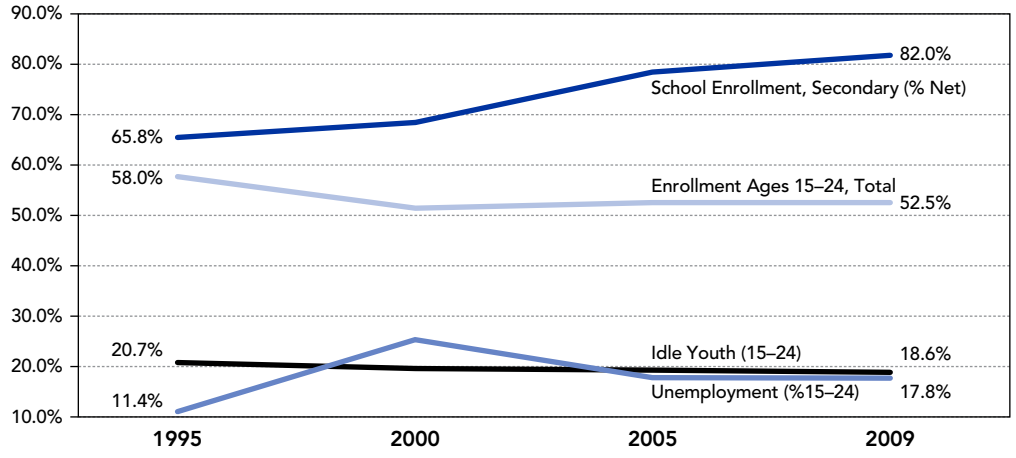
Young individuals are not benefiting from increasing economic growth and labor opportunities to the same extent as adults. Indeed, recent studies suggest that idleness is associated with factors such as extreme poverty and youth long-term unemployment. More research is needed on the role of other determinants, including drugs, alcohol, distance to school, teen pregnancy, violence, the number of siblings in the household, and household structure.[11]

Millions of Women Missing from Formal Labor Markets

A microtrend that has become a macrotrend in recent years is the share of women in the formal labor force. Over thirty years, participation rates moved by 10 to 15 percentage points in most countries. However, if LAC female participation converged with the female participation rates in OECD countries, 19 million more women would be formally employed. And if participation rates of men and women converged in Latin America, 50 million more women would be in the formal workforce. Given the current structure of income

[11] For evidence about Brazil's idle youth see: Susana Martinez-Restrepo, "The Economics of Adolescents' Time Allocation: Evidence from the Young Agent Project in Brazil" (PhD diss., Columbia University, 2012). For evidence about Mexico See: Arceo-Gómez, Eva; Campos Vasquez-Raymundo, ¿Quienes son los NiNis en México? RePEc:emx:-ceedoc:2011-08, El Colegio de México, Centro de Estudios Económicos (2011).

Figure 2. Jobs, Schooling, and Idle Youth in Brazil from 1995 to 2009



Note: Author's own elaboration using the Socio-Economic Database for the Latin America and Caribbean (SEDLAC)—World Bank Data and the World Development Indicators.

generation and poverty reduction, a massive shift of women into formal labor markets is a must for future gains.

The literature on female labor participation points to economic, cultural, and technological obstacles (Goldin, 1997; Gutierrez, 2009; and Katz and Goldin, 2008). Beyond averages, however, there are particular stories that merit closer scrutiny. The key question is whether and how policy interventions can change incentives for increased participation, opening the way for millions more to move out of poverty.

Two microtrends stand side by side in Figure 3. First, the richest 20 percent of the female population in Brazil is moving in the direction of greater female labor participation and higher incomes. Secondly, the poorest 20 percent of the female population is moving toward declining labor participation. Within age groups, labor participation rates have flattened for 15- to 24-year-olds since the 1990s.

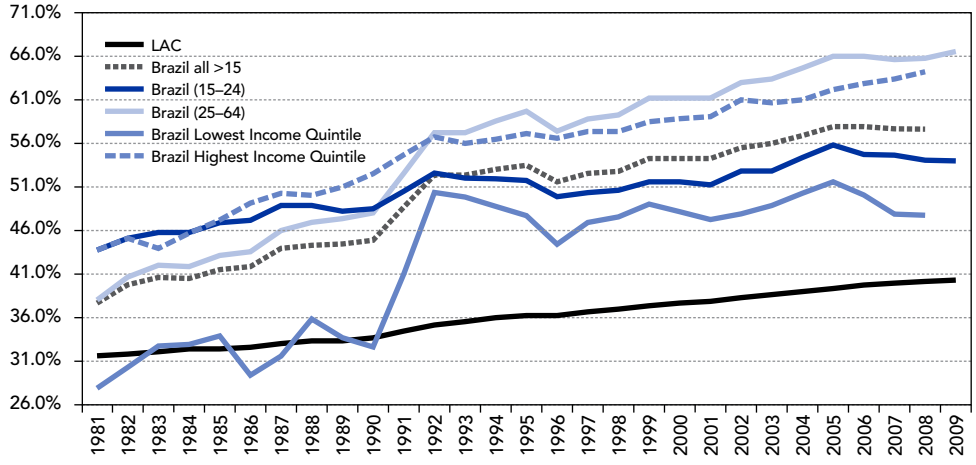
Despite the overall educational upgrade, the labor market seems to be benefiting low-skilled males in the informal sector.

Another interesting microtrend surfaces in the Dominican Republic. Despite the overall educational upgrade, the labor market seems to be benefiting low-skilled males in the informal sector. Figure 4 shows a change in the education attainment of unemployed individuals. In 2005, most unemployed males and females were those with no more than primary education. Today, employment among individuals with tertiary (higher) education has increased 3 percent; for those with secondary education, it has grown 7 percent since 2005. That means the gender gap closed for the unemployed with secondary education but increased for those with primary education, affecting more females than males.

Recent evidence suggests that the fall in the skill premia affects both employment and wages.[12] In a 2006 study, Levy and Murnane argue

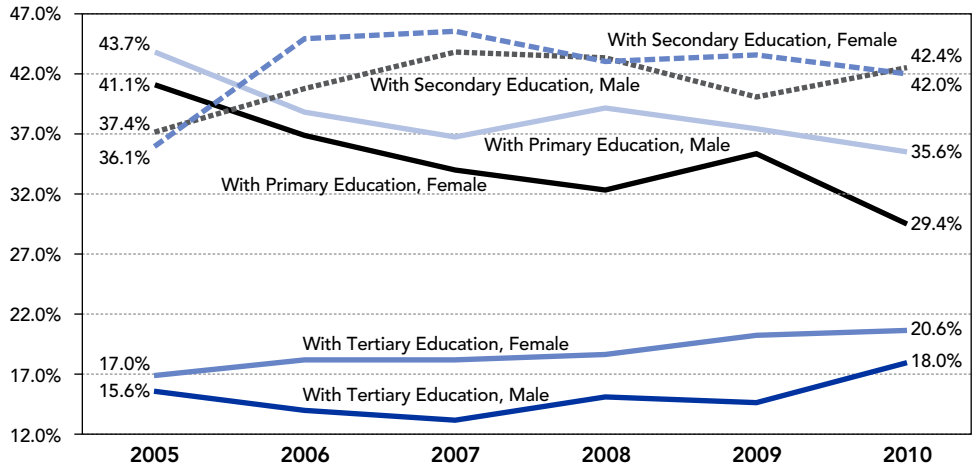
[12] Gasparini, et al., *Educational Upgrading and Return to Skills in Latin America Evidence from a Supply-Demand Framework, 1990–2010.* Policy Research Working Paper 5921, (Washington, DC: World Bank, 2012).

Figure 3. Labor Force, Female (% of Total Labor Force)



Note: Author's own elaboration based on the Socio-Economic Database for Latin America and the Caribbean (CEDLAC and the World Bank)

Figure 4. Share of unemployment by education level and gender



Source: Authors' elaboration based on data from the World Development Indicators.

that middle-skilled jobs are most vulnerable to an increasingly global labor market, suggesting that while low-skilled service workers must be on-site, (e.g. janitors, security guards, restaurant helpers, nursing home workers, construction workers, cleaning personnel), middle-skilled jobs such as those in call centers and offices can be outsourced offshore. These studies should be viewed with caution since they used evidence from the United States and OECD countries.[13] Still, the finding seems to apply to certain sectors in the Dominican Republic. Its tourist industry produces many direct and indirect jobs, most of which are low skilled and low paid. Recent evidence reveals a drop in male and female participation in manufacturing industries that employ middle-skilled workers. Males present minor but increasing labor participation in transportation and commerce. Job informality remains very high and constant since 2000 in the Dominican Republic among both males (48 percent) and females (47 percent).

[13] Frank Levy and Richard J. Murnane, *For now, middle-skilled jobs are the most vulnerable, CESifo Forum*, Ifo Institute for Economic Research at the University of Munich, vol. 7(2), pages 38-38, 07. http://www.cesifo-group.de/portal/pls/portal/docs/1/1191752.PDF

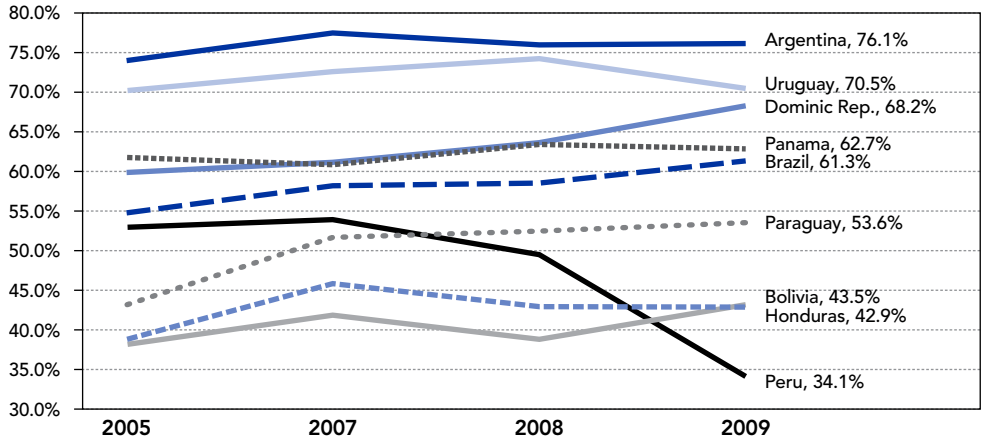
Lopsided service sectors

Recent growth has brought increased service sector employment and a decreased share in manufacturing and primary activities. Commerce, construction, and educational and health services have been particularly important employers. The current composition of service sectors tends to weigh heavily in favor of low-skilled, low-pay labor markets.

Peru, however, suggests a different story. Although the service sector accounts for 56 percent of total jobs, Peru is the only country among those studied in this brief where the service sector share has decreased and primary activities has increased. Figures 6 and 7 show that most job creation since 1995 has occurred in the agricultural and mining sectors (particularly primary mining activities).

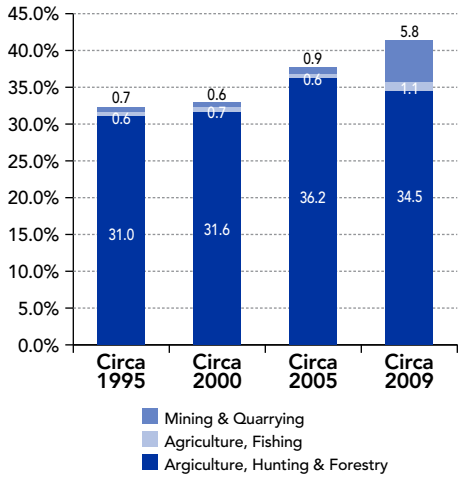
Despite a general decrease in the service sector's share of the overall economy, industries such as commerce, transportation and communications, and health and social services have increased their share since 1995. Peru's strong economic growth since 2003 mainly stems from a booming tourism sector and the development of agriculture

Figure 5. Service sector as % of occupied labor force



Note: Author's own elaboration based on the Socio-Economic Database for Latin America and the Caribbean (CEDLAC and the World Bank)

Figure 6. Share of employment within primary activities



Note: Author's own elaboration using aggregates of national household surveys calculated by SEDLAC—World Bank.

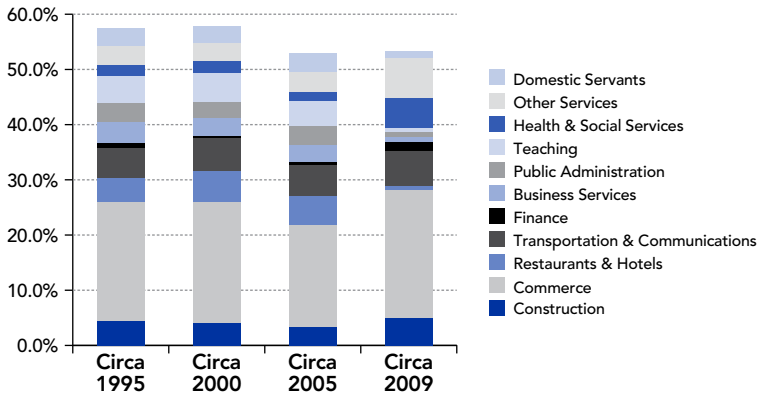
and agro-business, the extractive industry sector (mining), and infrastructure.

Despite a greater share of the primary sector in overall employment, the service and manufacturing sectors have seen a stronger increase in monthly wages since 1995. Wages in main activities in the service sector went from US$3,638 in 1995 to US$4,973 in 2009. In the manufacturing sector they rose from US$962 to US$1,402. They also increased in the primary sector but at a lower rate, going from US$231 to US$353. This data suggests that workers in the service sector are benefiting most from Peru's recent economic growth.

Informal jobs accounted in 2009 for 63 percent of total workers in the labor market and, despite a recent reduction, claim the highest share among selected countries.

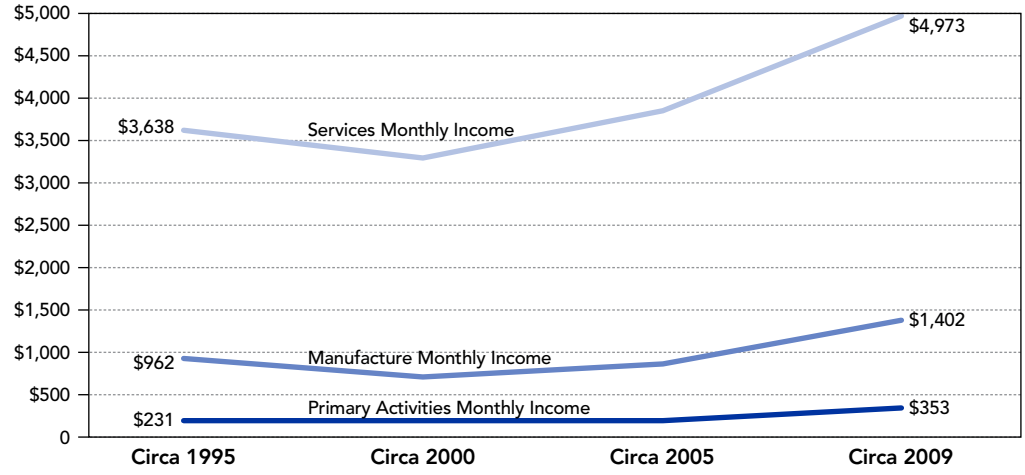
The aggregate figures do not account for the fact that within each sector, there are different types of jobs. The mining sector, for example, employs both highly qualified and highly paid individuals such as mining managers as well as low paid and low qualified individuals such as miners. Workers in low-productivity jobs are the high-hanging fruit of current economic growth. What policies are needed to address economic growth that also maintains existing structural economic inequalities?

Figure 7. Share of employment within the service sector



Note: Author's own elaboration using aggregates of national household surveys calculated by SEDLAC—World Bank.

Figure 8. Distribution of Services, Manufacturing and Primary Activity wages (US$)



Note: Author's own elaboration using aggregates of national household surveys calculated by SEDLAC—World Bank. Informality refers to salaried workers in a small firm, the non-professional self-employed, or a zero-income.

Will Social Gains Slow Down?

Fiscal constraints slow parts of the expansion

Despite the fiscal space gained since the 2008–2009 crisis, there remain serious obstacles to raising tax revenue levels in most economies, excluding Brazil, Uruguay, and Argentina.[14] Current revenues, at about half the OECD rates, seriously constrain spending priorities. Most new spending beyond inertial public sector allocations has focused on expanding social transfers or broadening public sector employment. With close to 113 million social transfer recipients (25 percent of the population), it is worth considering whether transfers will expand or target increasingly excluded groups.

There are at least three aspects to the fiscal constraint question. The first concerns the sources of fiscal expansion. The region currently raises revenues from value-added taxes and social security contributions, followed by specific consumption

[14] IMF, *World Economic Outlook*, Washington, DC: IMF, April 2012).

taxes. Corporate and income taxes still lag.[15] In federal countries like Brazil, Argentina, and Mexico, a large share of revenue mobilization occurs at the subnational level and/or is earmarked to subnational spending or investment priorities. There are few additional revenue sources beyond income taxes, which already grate against middle-class preferences. A new fiscal pact will need to focus on the structural demands of a growing population.

A second concern is that the pro-poor impact of fiscal transfers is still low or moderate. Barring Chile, Brazil and, perhaps, Argentina, CCTs and other non-conditional transfers are not making much of a dent on poverty or income inequality.[16] Transfers are typically too small to make up for large poverty gaps at the bottom of the distribution, and transfers typically show a lot of leakage from poor to non-poor households. Besides, most CCTs are not meant to bring households out of poverty. Rather, they are designed to provide demand incentives for human capital accumulation, to allow children to go to school, and for use of public health services.[17] The supply side is frequently missing in social services, and this deficit, which is both material and human resource-based, will take decades to fulfill. This is particularly important for countries with large rural populations and for rapidly growing urban centers that haven't caught up with demand in the 2000s.

The double burden faced by millions of women acts as a hidden subsidy on society, markets, and the state, undergirds the welfare regime, and is blatantly unfair.

A bridge from CCTs to a universal safety net is needed

The move from targeted transfers to a universal basic income or service safety net is riddled with challenges, the most important of which are around female labor participation and youth employment. A welfare regime perspective is useful to gauge the magnitude of this shift.[18] While most OECD economies are underwritten by market-led or state-provided safety nets, pensions or insurance from risk, most Latin American households are "familistic" in their labor and income strategies. The double burden faced by millions of women acts as a hidden subsidy on society, markets, and the state. It undergirds the current welfare regime and, among other things, is blatantly unfair.

Transitioning millions of women or youth into the labor force will require a new type of social compact that transcends fiscal revenue pressure. This issue is likely to dominate future discussions of social policy because it intersects with job creation and other economic policymaking. Santiago Levy has looked at one important aspect, the behavioral impact of social protection policies over labor markets.[19] An additional examination has been provided by a burgeoning literature on the economics of care.[20] Both strands of research focus on the balance between labor markets and household decision-making.

[15] OECD, ECLAC and CIAT, *Revenue Statistics in Latin America*, (Santiago: CEPAL, 2012).
[16] Nora Lustig et al, "Fiscal Policy and Income Redistribution in Latin America: Challenging the Conventional Wisdom," (New Orleans: Tulane University and Inter-American Dialogue, 2011).
[17] Simone Cecchini and Aldo Madariaga, *Programas de Transferencias Condicionadas: Balance de la experiencia reciente de América Latina y el Caribe*, (Santiago: CEPAL, 2011).
[18] Juliana Martinez, "Welfare Regimes in Latin America: Capturing Constellations of Markets, Families and Policies" (Latin American Politics and Society, vol. 50, 2: 67-100, 2008).
[19] Santiago Levy, *Good Intentions, Bad Outcomes: Social Policy, Informality, and Economic Growth in Mexico*, (Brookings Institution: Washington, DC, 2010).
[20] Valeria Esquivel, "La economía del cuidado en América Latina: poniendo a los cuidados en el centro de la agenda," (Area de Practica Genero, PNUD: Panama, 2012).

A third strand of work pulls some of these concerns together.[21] Economic policymaking has focused on stabilizing welfare in turbulent times and promoting economic growth in the good times; social policy tends to be compensatory and/or aimed at long-run human capital accumulation. The key in the future will be focusing on job creation with both market and state-led policy levers.

Are good jobs out of reach?

In many respects, these are the best of times for labor markets. Participation, as measured by hours worked, is expanding. Labor income, as measured by income per hour, is also on the rise. But two forces move against "good job" creation in the region. The first is macro, linked to the pattern of economic specialization, technology content, and export diversification of Latin American economies. Most growth is driven by a surge in commodity demand. While this has not been detrimental to growth, it has structured incentives for labor market upgrading in the 2000s. The second force is micro, linked to the pattern of female labor participation and youth employment. The sectors that create jobs are not likely to break through to non-participating females and youth. The incentives are not there. The welfare regime that might employ more women in the labor force is largely absent in the region and shows little signs of materializing. Together, macro and micro incentives create a scissors for future poverty alleviation.

Time-use surveys show that the gap between male and female labor participation will not close without behavioral changes in the household and incentives from the state. What is stopping reforms? Part of the answer seems to be political. But part is managerial: Why engage in gender-equalizing, productivity-enhancing sustainable development reforms when *cutting* the cost of doing business in the region is often seen as more expedient for competitiveness.

What to Expect in the Future?

Can we expect further poverty reduction from a longer growth spell in Latin America and the Caribbean? In this essay I have argued that much of remaining poverty—the 167 million people under the poverty line last year—is concentrated in hard-to-reach pockets, sectors, and geographic areas, either excluded from dynamic labor markets or as yet untouched by social safety nets. More of the same will not accelerate poverty reduction.

Two factors are likely to slow down progress in the near future. First, an aging population in many countries will bring an end to the demographic dividend that led to a record expansion in the number of people in the labor force this decade. Second, fiscal constraints will not allow a smooth transition from safety nets to universal social protection floors. Without an income floor for the poorest, the competiveness of Latin American economies will continue to be based on cheap labor and not on incentives for educational and technological upgrading. Without social benefits in the informal sectors, the risk premium will be too high for poor and vulnerable households to move into high-productivity, yet flexible, economic activities.

Latin America is approaching a crossroads. The best of times show us what happens when we get our economic-growth wish. This might be the opportunity to focus on our social wishes to spur future progress.

[21] Juliana Martinez and Diego Sanchez Ancochea, "The Productive Bottlenecks of Progressive Social Policies: Lessons from Costa Rica and Beyond," CROP Poverty Brief, (Bergen: CROP, 2011).

Comment by
Augusto de la Torre

George Gray Molina offers an accomplished overview of social trends in Latin America. After describing the social gains (poverty reduction, rising labor incomes), the paper focuses on key remaining challenges, including those posed by about 170 million Latin Americans who still live in poverty, the nearly one-fifth of young people (in the 15–18 age range) who are out of school *and* out of work, and the rising share of employment in service sectors of low skill intensity. These are, indeed, two big challenges that need to be addressed by policy with a sense of urgency.

While I share most of the paper's assessments, I think that it underplays the extent of the social progress achieved by the region in the past decade, notably the strong rise of the middle class, from about 20 percent of the population in the 1990s to about 30 percent at present, a phenomenon extensively analyzed in our 2012 flagship report *Economic Mobility and the Rise of the Latin American Middle Class*. I also regret that the paper is silent on what is now the most populous economic class in Latin America, the class sandwiched between the poor and the middle class, a "vulnerable class" that accounts for a whopping 40 percent of the region's population. Both the new "middle class" and the large "vulnerable class" call for a second generation of reform in social policy, one that maintains but goes beyond (conditional cash transfer-type) *social assistance* and puts a premium on the *social insurance* component of the social protection system (pensions, health services, unemployment protections), a component that is in much need of repair.

I concentrate the rest of my comments on the issue of female labor force participation (FLFP), where I find myself disagreeing with the paper. Gray Molina seems to suggest that achieving gender parity in labor force participation should be a goal in and of itself. I think this is not the right way of looking at gender policy. The focus should not be on equalizing *outcomes* (such as labor force participation) across genders always and everywhere but, rather, on equalizing *access* to fundamental human rights and basic services such as health and education, strengthening *cooperative interactions within households*, equalizing *opportunities*, and broadening *freedom* of choice. As discussed in a recent report produced in my office (*Work and Family: Latin American Women in Search of a New Balance*, by Laura Chioda, 2011), this shift of emphasis is warranted by the evidence.

For starters, cross-country data show that the relationship between FLFP and economic development is not linear but, rather, U-shaped. At low levels of per capita income, FLFP is very high because women have no choice but to work in order to survive and help their families survive. As per capita income rises, FLFP declines for a number of reasons, including constraints that women face in combining labor force participation with family formation. At the higher levels of per capita income, FLFP rises again, as women become more educated, freer from traditional gender roles, and able to more flexibly combine their career aspirations with their family-related aspirations (not least due to improved labor market legislation and such public services as childcare and preschool education). Hence, two countries at very different stages of development can have the same FLFP rate, but with that rate reflecting very different underlying conditions in terms of, say, gender discrimination, fundamental human rights protection, and degree of equality of access to education and health. This sort of U-shaped FLFP can help explain the fact (shown in Figure 4) that FLFP for Latin American women with less than secondary education has been on the decline, even as their per person income has been on the rise.

The formal sector fails to offer married women the flexibility and other characteristics they prefer and seek so as to achieve a better work-family balance.

Partly because of the U-shape of FLFP, policies that help remove gender-based discrimination or equalize access do not necessarily lead to increases in FLFP. For example, the introduction of publicly sponsored childcare services in Argentina and Brazil did not result in a sharp increase in FLFP (as policymakers had expected) but allowed already working mothers to labor more hours, move from informal to formal jobs, and better manage family-work balance. The point is that well-designed gender policy should aim at improving the welfare of women, and such welfare does not map one-to-one with FLFP rates. The non-mechanical link between equality of access/opportunity and equality of outcomes obviously points towards a complex mediation mechanism involving human capital, interactions within households, and social norms and preferences.

The evidence, in fact, suggests that the constraint is not so much on the decision to work (i.e., Latin women who want to work do work, by and large) but on the degree of formal labor market friendliness that working women face. This is particularly important for married women. In fact, FLFP for single women in Latin America is already as high as that in the United States. Gender-based wage gaps do seem to exist, but these may reflect choices geared at achieving a better work-family balance more than discrimination.

Latin America seems unique in that marriage, rather than having children, is the event that causes women with less-than-tertiary education to leave the labor force in droves, and mainly by choice. This suggests that social norms matter. These norms notwithstanding, there is plenty of evidence in the region and elsewhere, even in Scandinavian countries, that working mothers are in search of flexibility. This is illustrated in Latin America, for example, by the fact that while single women are over-represented (relative to men) in the formal sector, married women are over-represented in the informal sector. The likely reason is that the formal sector fails to offer married women the flexibility and other characteristics (part-time employment, flexible work hours, telecommuting arrangements, more cooperative settings, etc.) they prefer and seek so as to achieve a better work-family balance. It is a well-documented fact that women all over the world (in middle-income and rich countries) struggle emotionally more than men with this balance.

As the region moves toward a stronger, evidence-based gender policy, a shift of emphasis will be needed from a gender-parity, outcome-driven agenda to one that is gender-sensitive and driven by equality of opportunity.

Comment by Diego Sanchez-Ancochea

Latin America has apparently reversed course over the last ten years. After seeing poverty increasing by 40 percent in the period 1980–2002, the number of poor people went down from 225 million to 167 million between 2002 and 2012.[1] Higher economic growth, greater formal employment, and a more effective redistribution of income have contributed to renewed optimism in Latin America. But will this trend continue? Has Latin America finally broken with history, to paraphrase the famous 2002 World Bank report on inequality? Will the region continue its upward trend towards equity in the next thirty years?

In his contribution to this volume, George Gray Molina offers a fascinating exploration of these questions. By going beyond the macro-numbers and considering micro-trends, he identifies recent winners and losers and highlights future challenges. Latin America's commodity-based economic model has failed to incorporate many women and young people into the labor market and the welfare state. Latin America's excessive reliance on low productivity jobs may also constrain future productivity and wage growth. Gray Molina also proposes a rich and creative development agenda for the future. We need sectoral policies that, on the one hand, create high productivity sectors and add value to commodity production and, on the other, expand capabilities and learning within low productivity activities. New social policies must simultaneously help people to enter the labor market and to access free services as rights. Confronting the lack of public childcare and expanding the school day in primary education, for example, would be particularly important.

Will the region meet these policy challenges in the future? Gray Molina does not quite address this. To begin answering this question, we first must decide which part of the region we are talking about. Latin America is increasingly divided between the winners and losers of the commodity boom. In contrast to positive trends south of Panama, Central America's recent performance has been unimpressive. In El Salvador, the percentage of people living in poverty was practically the same in 2002 and 2010; in Honduras, 43 percent are still indigent.[2] High oil and mineral prices, decreasing opportunities for migration to Europe and the United States, growing competition in labor-intensive manufactured goods arena, and high levels of violence and drug trafficking have contributed to make Central America's challenges particularly overwhelming.

While acknowledging these differences is extraordinarily important, Gray Molina prefers to emphasize common micro-trends. Women's labor participation rates are low across the region and good jobs and adequate social programs are in short supply almost everywhere. What he does not discuss is Latin America's biggest common political problem: the concentration of income and political power at the top. Income distribution may have improved as the middle class grows, but the top 1 percent remains more powerful than anywhere else in the world. Household surveys indicate that their income power has contracted, but wages in the financial sector point to a different story. In 2010, for example, CEOs and company directors earned more in São Paolo than in New York, London, or Hong Kong.[3] A recent study of top incomes in Colombia using tax returns confirms the stability

[1] See http://www.cepal.org/prensa/noticias/comunicados/9/48459/grafico-evolucion-pobreza-indigencia-en.pdf (last accessed February 27, 2013).

[2] See http://www.cepal.org/prensa/noticias/comunicados/9/48459/tabla-pobreza-indigencia-en.pdf (last accessed February 27, 2013). The data for Honduras is from 2010.

[3] See http://www.economist.com/node/18010831 (last accessed February 27, 2013).

> Income distribution may have improved as the middle class grows, but the top 1 percent remains more powerful than anywhere else in the world.

of inequality at the top. The richest 1 percent of the population received 20.5 percent of total income in 1993 and 20.4 percent in 2010—despite an overall reduction in the Gini coefficient.[4] The persistence of income concentration among the rich has significant implications for the political process and Latin America's future policy trajectory. First, the elite in most countries still has an overwhelming influence in politics through campaign financing and other channels. Second, elite power makes the expansion of income taxes—still a major challenge in Latin America as pointed out by Gray Molina's paper—extremely difficult. Even the most radical governments have failed to pass major income tax reforms in recent years. Third, the informal coalition between the elite and the upper middle class still skews the nature of social policies in many countries. In Brazil, for example, successive governments "have protected privileged interests: influential groups have maintained and, in some cases, even expanded their already substantial benefits."[5]

The reduction of the economic power and political influence of the top income groups is by no means a sufficient condition to secure more progressive development policies in the future, but it is probably a necessary one. Some governments, like the Venezuelan one, at least rhetorically placed this objective at the forefront of their political agenda, yet their confrontational stand and lack of attention to state reform may do more harm than good in the long run. More effective and professional bureaucracies, more progressive technocrats, and more active social movements may be the ingredients needed to gradually shift power in society, strengthen accountability, and slowly promote all the policies that will marry our social and economic wishes for decades to come.

[4] Facundo Alvarado and Juliana Londoño (2013) "High Incomes and Personal Taxation in a Developing Economy: Colombia, 1993-2010" (mimeo). The top 1 percent in Colombia received a higher income share than in any other country in the world with the exception of the United States in a few years.

[5] Wendy Hunter and Natasha Sujiyama (2009) "Democracy and Social Policy in Brazil: Advancing Basic Needs, Preserving Priviledged Interests," *Latin American Politics and Society*, 51(2): 29-58, page 29.

Global Trends and How Latin America Should Think About the Future

BY SERGIO BITAR

Serious exploration of the region's future is impossible without a global outlook. To govern better, it is therefore crucial that Latin American countries strengthen their capacity to engage in forward thinking and strategic reflection. This will help them to take advantage of opportunities and to anticipate risks. Nations must become familiar with global scenarios and, within them, the types and scale of challenges they may confront. Latin American governments will need to learn how to act when conditions are uncertain and rapidly changing.

The leading powers have been engaged in the systematic examination of world trends, giving developed countries a competence for global foresight that is generally unknown in Latin America. The greatest capacity comes in the United States, where the National Intelligence Council as recently as December 2012 released *Global Trends 2030: Alternative Worlds,* which draws on extensive consultations with experts from around the world.

The European Union (EU), similarly, published a 2012 report by the European Union Institute for Security Studies titled *Global Trends 2030: Citizens in an Interconnected and Polycentric World.* Individual countries such as Singapore and Finland have also been at the forefront of such study, and some emerging countries, notably China, South Korea, Russia, and Brazil, are heading in this direction.

Six Global Trends

The Inter-American Dialogue has set up, and is updating, a registry of more than 500 long-term, global, and sector-specific studies published in recent years. A review of the most relevant of these helps us to identify six global trends the region should watch:

1. *"Disruptive" technologies* bringing substantial changes in production, employment, well-being, governability, and human relations.
2. *Natural-resource scarcity* affecting water, foodstuffs, energy, and minerals in tandem with changes in demand and production.
3. *Demographic changes* resulting in new markets, middle classes on the rise, migration, and the displacement of power.
4. *Urbanization and the growth of cities* altering population concentrations, demands for infrastructure and basic services, quality of life, and the competitiveness of cities.
5. *Climate change* affecting agriculture, "green growth" opportunities, behavioral change, and citizen action.
6. *Democratic governability* influencing the interconnection of global citizens, the impact of new technologies on social relations, transparency, security, and violence and organized crime.

Detecting Unexpected Events

In addition to these overarching trends, we should be aware of other events that may have low probability but, should they occur, carry sweeping impact. They include:

- Acceleration of climate change and possible rises in sea levels—with adverse effects on many coastal populations—as well as greater-than-expected temperature changes. The repercussions for agriculture, rainfall, and health will be more profound than early studies anticipated.
- Cyberattacks on networks that control electricity transmission, communications, financial systems, logistics, food production, and other basic services. Some experts maintain that cyber risks pose more danger than nuclear threats.
- Food insecurity brought about by increases in prices and the imbalance between production and demand in dry zones or water-scarce areas. The negative effects will be felt most strongly by the world's poorest.
- Aging populations and growing concerns around the financing of social security, as well as fiscal indebtedness and related effects on productivity and waning competitiveness, especially in Europe.
- Geopolitical tensions in the south and east China seas and in the Indian Ocean.

Challenges for Latin America in the New Global System

Latin America is lagging behind in the knowledge of global trends and their implications for policymaking, but it could quickly catch up by using studies from the developed countries, creating analytical groups in Latin America, and establishing networks among those groups. In recent years, forwarding-looking reports have been created in the region, including *Brasil 2022* (Brazil's Secretariat of the Presidency); *México, Visión Nacional 2030* and *México 2042* (written in 2012 by the Centennial Group in Washington, D.C., in collaboration with Mexican organizations); *Visión Colombia 2019; Chile 2025* (Colegio de Ingenieros de Chile, 2012) *and Agenda Chile País Desarrollado: Más Oportunidades y Mejores Empleos, 2010–2018; Plan Perú 2021; Ecuador, Estrategia Nacional 2010/2025;* the Dominican Republic's *Estrategia Nacional de Desarrollo 2030 and Un viaje de Transformación hacia un País Mejor, 2030;* and Uruguay's *Estrategia Nacional de Desarrollo 2030.*[1]

Latin America is lagging behind in the knowledge of global trends and their implications for policymaking.

In addition, on a regional scale, CAF—Development Bank of Latin America commissioned the report *América Latina 2040*[2] and the Millennium Project prepared *Latinoamérica 2030.*[3]

Recent studies about Asia are also relevant to Latin America's future. Notable among them are *China 2030* (prepared by the Chinese government and the World Bank, 2012), *India 2039* (Centennial Group, 2011); and *Asia 2050* (Asian Development Bank, 2011). It is instructive to contrast Latin America with Asia, where a lack of natural resources has obliged countries to be more creative, pushing them to specialize and to improve the capacity of their human resources, their educational systems, and their technology. Asian countries have shown the political resolve to put their sights on a distant horizon.

How could the development strategies of each Latin American country change if long-term

[1] See Alicia Bárcena in *Latinoamérica 2030,* by José Luis Cordeiro et al. (Washington, DC: The Millenium Project, January 2013).

[2] Harinder S. Kohli, Claudio M. Loser, and Anil Sood, *Latin America 2040; Breaking Away from Complacency: An Agenda for Resurgence* (Thousand Oaks, CA: Sage Publications, 2010).

[3] *Latinoamérica 2030, op. cit.*

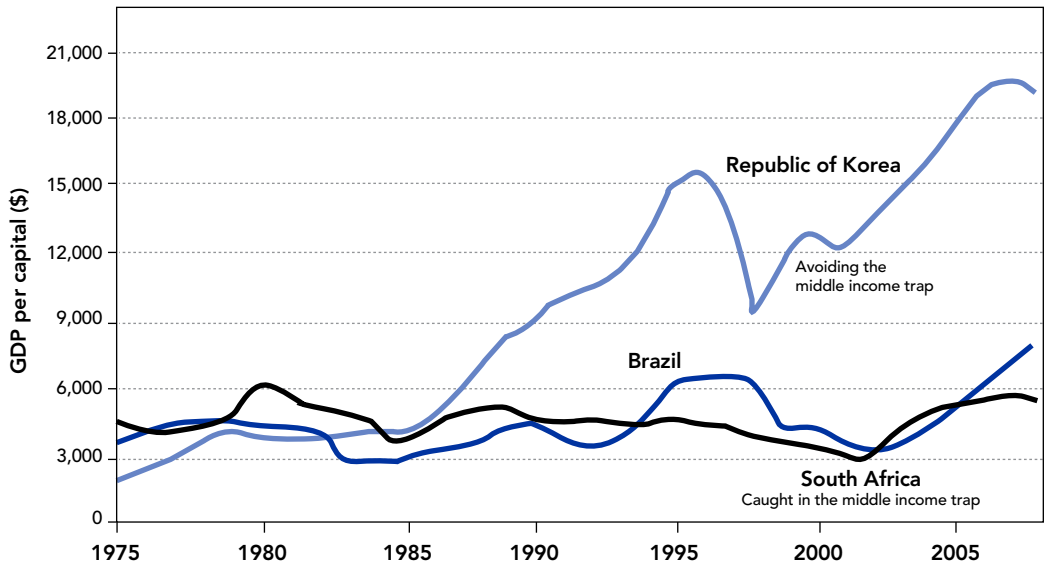
global trends are taken into account? Positive developments of the past twenty years have nourished confidence in the region's own capacity. The spread of democratic practices; more coherent macroeconomic management; an increase in per-capita output driven by exports of minerals, fuels, and foodstuffs; and an emphasis on social welfare have inculcated a positive spirit, albeit one that is also more complacent.

Can Latin American countries escape from what has been called the "middle-income trap") and achieve at the same time a deepening of democracy, social inclusion, and environmental sustainability?

Aware of these challenges, almost all Latin American governments have asserted their willingness to tackle at least four long-term goals:

1. *Consolidation of democracy* through institution building, citizen empowerment, stable local government, stronger civil society, greater transparency, and international agreements on global governance.
2. *Transformation of the productive structure* in order to gain greater competitiveness and specialization. Keeping sound macroeconomic management, creation of decent jobs and worker training, enhancement of small and medium enterprises (SMEs), adoption of technological innovation, and provision high-quality education for all.
3. *Social inclusion* as a result of a reduction in poverty and inequality, the elimination of discrimination, and the establishment of equality of opportunity. This goal will be reached by setting up a social welfare network and by improving social well-being. Housing, healthcare, education, high-quality public spaces in the cities, public transportation, digital communications networks, and citizen security will be its markers.
4. *Latin American cooperation and integration* stemming from new alliances that enlarge the regional market, including agreements on trade, investment, taxes, infrastructure projects, and

Escaping the Middle Income Trap?



Source: *Asia 2050: Realizing the Asian Century. Executive Summary*. Asian Development Bank, 2011.

National governability in a multi-polar world increasingly will be conditioned by global governability.

energy. Political coordination and joint economic action will reduce vulnerability and help bring about changes in international institutions.

5. *Sustainable development in light of climate change.* While this may not appear now as a government priority, there will be pressure, including from civil society organizations, to adopt policies affecting technologies, water and energy consumption, deforestation, and fishing. This will be required in order to ensure exports, process natural resources, and guarantee quality of life.

Attainment of these goals does not depend solely on national decision-making. Rather, they must be viewed in the light of global scenarios in order to determine which goals and policies merit reconsideration.

Deepening Democracy

Information and communications technologies will have a growing impact on how democracy operates and how governments manage. The rise in educational levels, as well as a standard of living that grants more autonomy to members of the middle classes, will spur demands for new forms of participation, transparency, and local power. Youth will have more skills and will be better equipped to communicate, coordinate and influence politics. But usually they are outsiders to political organizations. Will existing institutions be able to channel what is coming? New threats—among them a failure to renew the ranks of the elites, opacity, corruption, and inequality—could emerge to compromise democracy. Institutions are not responding adequately to such dangers. Concentration of power, the lack of social mobility, the weakness of political parties, or the loss of prestige of parliaments and politicians could provoke a drop in political participation or lead to disruptive action outside institutions. Social organizations and civil society will expand, but they may become a sword with a double edge: helping and also challenging governability. Latin America is a region of peace, without interstate conflicts, and also a region where democracy may become stronger and more creative. These two realities represent a big advantage that should be cultivated with timely reforms.

At the same time, national governability in a multi-polar world increasingly will be conditioned by global governability. Regional agreements will, therefore, become more important in tackling global challenges in the areas of finance, trade, the environment, and security in the face of organized crime.

Globalization requires more State, not less. Latin America could step up its global role if the region strengthened its political and economic cohesion.

Strengthening the Productive System

In contrast to successful countries in Asia and Scandinavia, Latin American countries accord almost exclusive primacy to sound economic management and neglect long-term trends in the world economy. Improved competitiveness calls for a more complex productive base of goods and services. Complexity is the variable that most closely correlates to productivity and development.[4] Achieving it requires simultaneous efforts in the areas of quality education, scientific and technological research, and infrastructure (transport, energy, and telecommunications). It also requires policy geared toward product differentiation and specialization.

[4] Dany Bahar, Ricardo Hausmann, and Cesar Hidalgo. *International Knowledge Diffusion and the Comparative Advantage of Nations. Center for International Development* Working Paper No. 235. (Cambridge: Harvard University, April 2012).

Latin America's future competitiveness will depend on energy, a field in which global conditions are quickly recalibrating.

Given technological trends, development will have to focus on countries acquiring comparative advantages in agriculture, aquaculture, minerals, solar energy, biofuels, biotechnology, communications, computing, and nanotechnology. Manufacturing and services will require more discerning actions for market identification, product design, and production technologies, with attention to transformative technologies such as 3D printing. Regrettably, what is known traditionally as industrial policy and, more recently, as specialization for competitiveness is mostly absent from the menu of options in Latin America.[5] Progress will not be made unless the State plays a more active role in coordinating public-private action through research centers and expert training, thereby raising productivity.

There is an urgent need to set up groups to monitor technological innovations, as well as the experiences of other successful countries with industrial policy, technical training, scientific development, and technological innovation. Latin American governments and international organizations should foster and finance these groups.

The main battle will be fought in the field of education. The OECD's Programme for International Student Assessment (PISA) and the Trends in International Mathematics and Science Study (TIMSS) reveal that the achievement among students in the region is modest. There is little long-term planning and few targets for the numbers and competencies of educators, technical specialists, and people with postgraduate qualifications who will need to be trained. There is an urgent need for educational studies that look ahead to global circumstances in 2030 and deduce the effects of those circumstances on each Latin American country.

Transformation of the productive structure entails not neglecting but, rather, enhancing export of natural resources by means of innovative technologies and by using surpluses to leverage specialization. The experiences and strategies of countries in Asia and in developed countries that have entered the green-growth stage should be obligatory reference points.

Latin America's future competitiveness will depend on energy, a field in which global conditions are quickly recalibrating. A recent game-changer is the increase in shale gas production in the United States, an expansion that has brought two great benefits for the country: greater supply security and lower production costs. Many Latin American countries are well endowed and the future may show increasing oil production and possible exploitation of important shale gas reserves in Mexico, Argentina, and Brazil, among others. If public oil companies improve performance, and investments and research increase, the region may become an important source of secured supply. It may also reduce emissions and costs for enhancing productivity.

Energy developments could affect European markets, pushing them toward lower-cost, coal-based power generation. They could also lead to a reduction in European energy purchases from Russia. At the same time, growing demand in Asia and the greater availability of energy from the Middle East could forge closer links between Asia and the Arab countries.

Beyond traditional energy sources, photovoltaic solar technology is leading to a dramatic fall in prices, while nuclear energy will expand in China, India, South Korea, and Finland, to

[5] *Cambio Estructural para la Igualdad,* (Santiago: ECLAC, 2012).

mention only a few countries. Similar progress can be expected in the area of biofuels. Latin American countries that are not endowed with fossil fuels should move earlier on green technologies, including solar, hydro, and biofuel.

To make the right decisions, countries will have to monitor long-term energy scenarios. This is another area of activity that Latin American governments and international organizations should support.

Making Society More Cohesive

Unless countries make determined political efforts to provide more equality of opportunity and social protection, global changes could heighten inequality—the cause and consequence of the lag in education and healthcare. Inequality sparks violence, endangers social peace, and holds back growth. In the future, social policies in Latin America will have to be reoriented away from poverty reduction and toward efforts to narrow the gap between rich and poor. As transparency and knowledge spread, abuses will be more evident. That will elevate the demands for the protection of rights. Social pressure will increase for equal treatment at all levels.

Social measures taken through pre-school education, housing, and healthcare, as well as the rising welfare costs attendant on aging populations will require increased government spending. Financial and tax planning call for these projections to be made over the next ten to twenty years under different scenarios. They should be the subjects of futures studies in every Latin American country.

To plot a course in the world now taking shape, political actors will have to draw up a new social and political pact that promotes real equality of opportunities, social inclusion, public goods, technology, and enterprise. Political actions will be more forceful if the study of future scenarios raises awareness as to the consequences of inaction, particularly the effects on governability and productivity.

Repositioning in Response to Global Trends

Regional integration, political and economic, is a priority in better positioning Latin America in the new world power structure. Four global trends will influence this and, therefore, have to be considered in policy design: 1) demographic change; 2) the displacement of economic and political power from the West to the East and South; 3) the influence of the middle classes worldwide; and 4) the speed of urbanization. If Latin American countries consider the impact of these trends, they will be better positioned to leverage opportunities that arise and to avert being relegated behind the Asian countries.

Population growth will spur new forms of consumption and change competitiveness. Countries with young populations may enjoy a "demographic dividend"—developing trained, low-cost labor forces and seeing their "emerging middle sectors" increase. Incomes and consumption will also surge.

Population growth in Asia and Africa will spark greater demand for foodstuffs and other material goods, in effect opening huge markets that could be supplied from Latin America. More detailed studies on the composition of emerging consumption would help guide the development of new products and services. Detailed studies would also help in the development of joint ventures among Latin American governments and companies in order to engage the huge Asian markets.

On the new map of global power, the Pacific region holds a position of privilege—signaling even greater opportunity for Latin America. To take full advantage of this, Latin America's foreign policy will have to advance a sound combination of initiatives with China, as well as with India, Indonesia, the Philippines, South Korea, Japan, and the Association of Southeast Asian Nations in general. A strategy toward China could focus

> Global changes could heighten inequality—the cause and consequence of the lag in education and healthcare.

on foodstuffs, energy, minerals, and joint projects in manufacturing and infrastructure. Latin America will also have to deepen opportunities with the United States and the European Union. Initiatives with the United States and the European Union could include agreements on education, energy and the environment, trade and investment, and closer collaboration in science and technology.

Changing global forces will require the formation of new alliances and greater regional integration. The growth of Latin America's middle classes will swell this internal market appreciably, making regional integration more attractive. It could also facilitate the expansion of Latin American businesses to other countries. Governments and international organizations would do well to encourage thinking about such matters, creating permanent venues for analysis that today barely exists.

As regards the growth of the middle class, it is crucial to study the new demands that will arise, how they will be channeled, what new products are to be offered and designed, and the joint actions required by Latin American countries. Because this middle class growth will appear in both Latin America and in other emerging regions, most importantly Asia, it is essential to visualize future scenarios of development in China, India and, more generally, Asia. The study of Latin American-Chinese relations through the year 2030 is a priority area.

Swift urbanization and the appearance of new cities shape the fourth factor that will affect development strategies. In response to the urbanization trend, Latin American cities will have to improve their efficiency and competitiveness and enhance quality-of-life offerings for their inhabitants. In 2035, some 315 million Latin Americans will live in 198 of the biggest cities in the region. It is estimated that those cities will account for 65 percent of Latin American GDP. These big metropolitan areas will require significant investments to address their weaknesses and to attract international activities. Long-term urban planning should be a priority.

Anticipating Actions to Tackle Climate Change

Natural disasters will tend to be more frequent. This tendency will carry with it migration to cities and transfers of families to more secure areas, with high human costs. If no consideration is given to preventive measures, such as relocating housing and infrastructure, living conditions—especially of the poor—will be gravely affected. Climate change will also affect agriculture, energy, and drinking water supplies. Countries need to set standards, measure environmental impacts, assess the effectiveness of the measures taken, and calculate the amount of investment needed in the most sensitive areas, such as dams, water system infrastructure, and coastal protection.

Governments should also review food security under scenarios involving a range of rainfall and temperature fluctuations, using that analysis to determine what measures might be needed and what plans should be made. To effectively address the most likely scenarios, countries will have to give priority to scientific and technological research in areas related to green growth, especially biotechnology, renewable energy, water- and energy-efficiency, biofuels, and public transport.

How to Prepare

To get ready for what's ahead, it is imperative that Latin America strengthens analytical teams within each of its countries at the same time it sets up a regional network for global analysis. The groups and the network, working closely with governments, should help design public policies.

The Inter-American Dialogue's project on Global Trends and the Future of Latin America, which is supported by the Inter-American Development Bank, is cultivating familiarity with global studies that may not be known in the region, with a view to developing national and regional foresight capacity. The Dialogue has drawn up a register of long-term global studies on issues of most importance to Latin America. The project seeks to help create a regional network of research institutions and scholars that study global trends and to link the network to global think tanks in developed countries.

For that purpose, the following would be useful:

- **Strategic planning units in each government,** close to the presidency or to institutions responsible for public policymaking; planning ministries should be reorganized.
- **Foresight committees in parliaments** to inform the long-term legislative agenda and disseminate future-focused analysis at the political level.
- Publicly financed **nongovernmental studies centers** to analyze scenarios and train specialists.
- **National and region-wide coordination** of networks of institutions and individuals that work on future studies; this includes the training of experts in pertinent methodologies and the creation of research teams.

Long-term projections should become part of the political discourse. This can happen if citizens are better informed about possible futures and if the vision of the future is endowed with a narrative that is more attractive to public policymakers. Such a common perspective could be the underpinning for long-term political pacts that are conducive to better governance.

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The Dialogue's select membership of 100 distinguished citizens from throughout the Americas includes political, business, academic, media, and other nongovernmental leaders. Sixteen Dialogue members served as presidents of their countries and more than three dozen have served at the cabinet level.

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