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AN ANALYSIS OF TRENDS:

Latin America and the Caribbean Economic Growth and the Environment, 2010–2020

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An Analysis of Trends:

Latin America and the Caribbean

Economic Growth and the Environment, 2010–2020

Funded by and prepared for the USAID Latin America and the Caribbean Bureau through an agreement with the USAID Global Health Bureau by:

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CONTENTS

Section One

Background and Purpose

As a foundation for improving the programming of development assistance to the Latin America and Caribbean (LAC) region, the U.S. Agency for International Development (USAID) recently partnered with the Woodrow Wilson International Center for Scholars (WWICS) to identify and analyze key challenges and opportunities for development assistance in the LAC region through 2020. This paper summarizes the key trends identified and proposes some general lines of action for USAID's Missions in the region.

To launch the strategic review, the Economic Growth and Environment teams of the LAC Bureau first polled in-country staff to identify their priority concerns for the region for the coming decade. The WWICS then designed and facilitated a series of thematically-focused roundtable discussions on these top issues. These discussions featured leading economic growth and environment experts, private sector representatives, and practitioners from the LAC region. Participants were asked to define major emerging trends in their field of expertise, describe likely cumulative impacts of these trends, and suggest how USAID might address these trends in programming to improve economic and environment assistance in ways that would foster more inclusive and sustainable economic growth and environmental stewardship.

Based on the roundtable discussions, WWICS prepared a draft synthesis paper that was presented and discussed with USAID Mission staff at a LAC regional conference held in Panama on May 3–5, 2010. At the conference, participants in breakout groups attempted to pinpoint key issues further by sub-regions (Caribbean, Central America, and South America). This paper builds on the conference discussions.

Sections I and II summarize the key demographic, economic, and environmental trends that will shape the future of the LAC region over the coming decade. In Section III, these trends' impact on economic growth and sustainability in the region is briefly discussed. Section IV identifies in a preliminary fashion, ways in which USAID could engage on addressing the challenges and strengthening the opportunities that the LAC region will face in the coming decade.

Not all of the LAC region's most prominent issues can be fully and adequately addressed here. A lead criterion used to select issues for inclusion was their relevance to the programming agenda of the USAID Economic Growth and Environment teams that sponsored this study. Other significant issues have been left unaddressed. Thus, the themes of governance, corruption and citizen security — currently so critical in the region — are developed only insofar as they affect prospects for economic growth and sustainable development. As noted in Sections III and IV, governance still figures as central even in this limited scope but does not appear as a key topic that the Economic Growth and Environment teams, by themselves, have a comparative advantage to address. It can and should, though, be taken on in coordination with USAID Democracy and Governance and even Education programs.

The report also does not present specific recommendations for USAID programming in the region, or an action plan for such work. Rather, the document is intended as one input that incoming LAC Bureau leadership can use in setting new directions and concrete plans for how USAID funding should be oriented in the region in coming years. USAID missions in the region are invited to use the paper as background to inform their country- and region-specific planning.

We hope this study serves as a foundation for charting USAID assistance to the LAC region that can have ever greater impact in achieving more inclusive economic growth, environmental stewardship, and sustainable development.

Section Two

Summary and Overview

In the coming decade, the countries of Latin America and the Caribbean face both historic opportunities and possibly unprecedented challenges. Their ability to grasp the unique prospects for deepening social investment that their demographics offer, and to avert the damage that climate change threatens, will be key to future prospects. If USAID's missions in the region are more fully aware of the scope of both the promise and the challenge, they can better orient their support to partners in the region in a strategic fashion.

This paper first offers a high level survey of demographic, economic and environmental trends that are poised to shape the region's development chances during the coming decade:

- The first part of the trends survey focuses on demographic factors. Many countries in the LAC region are going through an "age structural transition" (AST), during which their active working population is larger than the total number of young or elderly dependents. This transition offers an historic chance to increase family savings and per capita investment in health, education and hence overall welfare. However, to realize the potential of this opportunity, policies that support macroeconomic stability, education, and health must be set in place and maintained. In many countries, the requisite enabling policies are not in place, raising the very real likelihood that the full "demographic dividend" of the AST will not be achieved.

- Two additional demographic trends, while secondary to the AST in overall implications, are noteworthy and important to USAID's programming. First, a large subgroup of the population — the indigenous and Afro-descendent communities of the region — is not participating in the transition. Their situation continues to call for special attention in any programming that seeks to advance equitable economic development. And the LAC region's urbanization — among the highest in the world — is accompanied by a host of urban issues that call for urgent attention.

- The second section of the trends survey provides a summary of key external and internal economic factors that are most likely to shape the region's choices during the coming decade. Improving macroeconomic policies underpinned a relatively quick recovery in the region from the downturn caused by the global financial crisis. And continuing high demand for raw materials from Asia will be a dominant trend for several, though not all, countries, particularly in South America. For Central America and the Caribbean, however, the United States and Europe will continue to be the key markets. Unfortunately, widespread and deeply rooted corruption threatens most countries' ability to respond adequately to new opportunities.

The final section of the trends survey focuses on the growing impacts of climate change that the region faces. If current emissions levels continue unabated, Latin America and the Caribbean will need to adjust to a host of somewhat unpredictable but very costly impacts, from sea level rise, through coral bleaching and changing rainfall patterns, to glacial melt and severe weather events. The costs of the necessary adjustments will make a significant difference in the growth prospects for most countries.

The second part of the paper focuses on four key issue areas that merit increased attention

KEY TRENDS FOR THE LAC REGION

Review of the data suggests five key trends for the region:

- The ***AST presents a possibly unique historic opportunity for the region's economies and societies*** to benefit from demographic trends. However, to realize the full potential of the AST, countries will need to commit to more supportive social and economic policies than currently are in place.
- ***Climate change*** is already having a discernable impact on the economies and peoples of the region, and it will continue to do so. Both climate change mitigation and actions to build resilience must be urgently stepped up.
- The LAC region (South America, in particular) is experiencing ***tighter integration with the Chinese economy and markets***. This growing economic relationship is based primarily on the exchange of primary products and commodities from LAC in return for manufactured goods from China. Such a relationship increasingly poses a challenge to governance in the region as economic growth based on purely commercial exploitation of natural resources and commodities comes into conflict with commitments to sustainable resource management and the well-being of rural and primarily indigenous and afro-descendant populations.
- Continued focus on ***promoting inclusion and sustainable economic opportunities for indigenous and afro-descendant communities*** is critical, as much for the regional economy as a whole as for these historically marginalized groups. The needs of socially and economically excluded groups must remain at the center of USAID's efforts.
- Sustainable and appropriate ***technological and management innovation is a lynchpin for reviving the region's lagging competitiveness***. Innovation does not have to be high tech or capital intensive but does need to promote investments and innovations that not only contribute to sustainable economic growth, especially in rural communities, but also help them to participate in the global market in a manner that is not entirely dependent on extractive industries. Diversifying production from primary products continues to be a priority form of diversification.

from USAID. These include climate change adaptation, the challenges of small economies in Central America and the Caribbean, indigenous and minority issues, and urban issues. The ongoing need for stronger growth policies, including a focus on supporting innovation, is also briefly assessed as a cross-cutting issue. All other policy areas depend on its success or failure. Preliminary suggestions for USAID action are identified in each focal area.

How should USAID respond to the emerging trends identified? At the Panama conference, discussion of the emerging trends and what they imply for USAID work in the region led to the conclusion that USAID has a sound base of policy analysis and programming already in place. It does not need to set aside all its current work and start over. Indeed, abandoning foundations already laid in sustainable natural resource management and strengthening the enabling environment for trade and investment would undermine the new work that is needed.

At the same time, USAID cannot and should not just continue business as usual. Some existing lines of work need to be re-oriented. For example, given growing awareness of climate change impacts as a "killer threat" to biodiversity, environmental work should refocus on strengthening mitigation and building resilience to the impacts already being felt. Similarly, on the economic growth front, increased attention is needed to supporting more widespread and effective innovation in management and technology, as a critical way for the region to final overcome its weak competitiveness in the global economy.

USAID, with its long-standing presence and strong reputation in the region, can build on the existing base of its programs in the region to help strategically guide resources into areas that address the region's key challenges, while taking advantage of the opportunities it faces. This paper points to lines of program activities that, according to expert opinion, would make a real difference for the region in the context it faces. USAID should take the analysis and ideas presented in this paper to the next level, by identifying exactly where its bounded, strategic focus will be in the region for the coming decade. By setting five to seven ambitious and strategic goals for the region and aligning all resources to achieve them, USAID can and will make a tangible difference for development in the region in the coming years.

Section Three

Key Context — Demographics, Economics and Climate Change

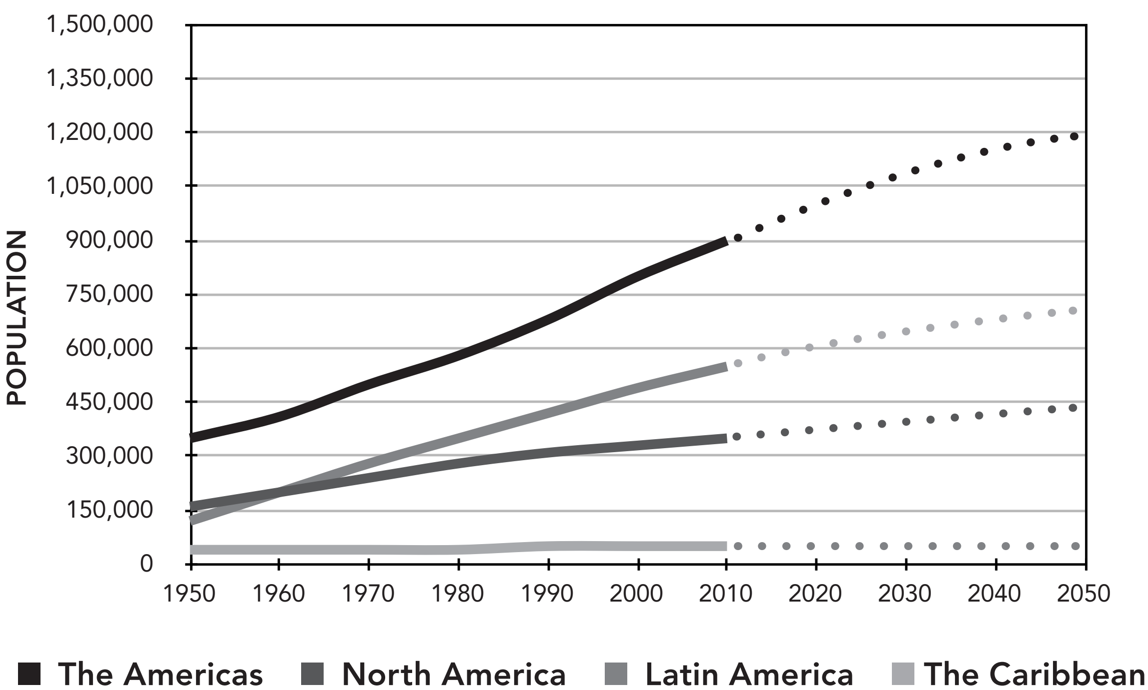
3.1 DEMOGRAPHIC TRENDS FOR 2010–2020

The LAC region continues to experience three major demographic shifts: overall population growth, urbanization and aging. All three of these trends are projected to continue during the coming decade, and all three will continue to shape the realities in the region in fundamental ways. Continued overall growth of the population clearly calls for continued job generation, infrastructure development and more efficient, sustainable means of resource extraction to meet the needs of a growing population. Urbanization has long been a focus of analysis and investment in the region due to its major impacts on population distribution, economies and social issues. It now is winding down as a demographic phenomenon. Major and serious issues of urban governance, livability and viability remain, however, and are growing. Perhaps the newest and least examined trend, however, is linked to overall population aging.

A. Age Structural Transition

The LAC region is moving through a major demographic transition, whose chief characteristic is that in many countries the working population exceeds — or will soon exceed — both aging and underage dependents. This shift of population structure, while not occurring in all countries,

FIGURE 1: POPULATION GROWTH IN THE AMERICAS, 1950–2050



Source: UN, *World Population Prospects, the 2008 Revision* through the USAID ESDB overall offers an historic window for increases in savings and investment for economic growth, at a time when relatively fewer resources are needed for investment in education.[1] The transition potentially gives greater leverage and amplification to the value of USAID investments in the region's economic growth over the next 5–10 years.

Latin America's "age structural transition" (AST) is rooted in overall falling fertility rates in many countries. Fertility rates have fallen in every region of the world, but the largest decrease has occurred in Latin America and the Caribbean. For the region as a whole, the total fertility rate has fallen from almost six children per woman in the 1960's to 2.2 in 2005.[2] It is expected to reach replacement level fertility (2.1) by 2015. As a result, LAC population growth rates are projected to decline from 1.5% in 2010 to roughly 0.75% by 2020.

This transition, labeled in the late 1990s as the demographic "bonus," "dividend," or "window of opportunity," generates a range of important economic and social opportunities for countries moving through it. These principally feature the ability of governments to invest more per person in maternal and early childhood health, in education, and in other basic services. A healthier, better educated population can then turn into a more highly skilled work force, attracting higher investment into the region.

FIGURE 2: LAC IN 2010

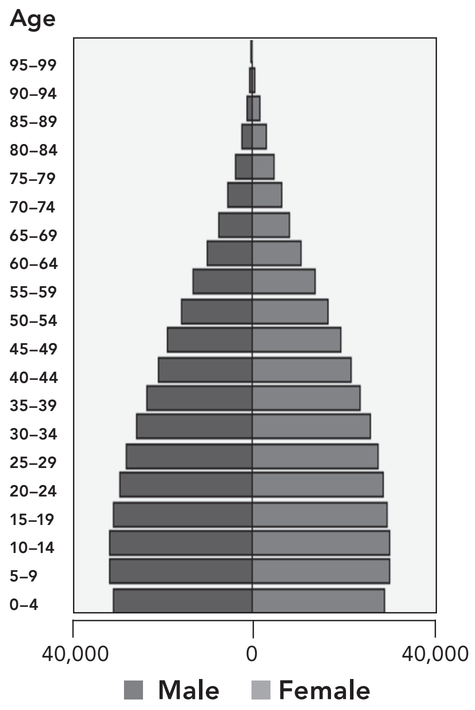
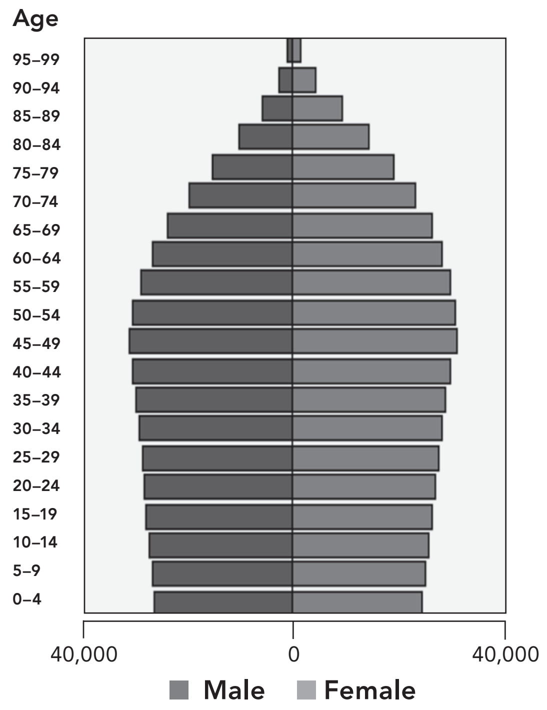


FIGURE 3: LAC IN 2050



Source: UN, *World Population Prospects, the 2008 Revision* through the USAID ESDB

[1] Hakkert, Ralph, "The Demographic Bonus and Population in Active Ages," IPEA/UNFPA Project RLA5P201: Regional Support to Population and Development in the Implementation of the MGD's in the LAC Region. Research Paper 7, Brasilia, DF. October 2007.

[2] The Total Fertility Rate (TFR) is an estimate of the number of children a woman will have in her lifetime. Because the calculation uses current age-specific fertility rates, it does not reflect possible future changes in age-specific and total fertility rates.

KEY TREND #1

The ***AST presents a possibly unique historic opportunity for the region's economies and societies*** to benefit from demographic trends. However, to realize the full potential of the AST, countries will need to commit to more supportive social and economic policies than currently are in place.

LAC success in taking advantage of the AST, however, will depend heavily on the ability of governments in the region to set in place and execute critical supporting policies, in education, job creation and fiscal stability. The external economic setting, along with political and social stability, must also be supportive to allow countries to take full advantage of this unique social and economic transition. While the demographic bonus is not guaranteed, some evidence suggests that to date Latin America has not been able to realize the full potential benefits of the transition. One analysis suggests that the demographic bonus in the region should have contributed 1.7% to an overall increase in GDP growth per effective number of consumers. The actual growth in GDP per consumer has in fact been 0.94%.[3]

USAID's focus on supporting education and fiscal stability policies that enhance the prospect of achieving a favorable framework for growth during the AST potentially can yield a special dividend or have an incremental leveraging effect in the coming five to ten years. However, the potential value of any amplified action heavily depends on the ability of the countries in the region to implement the policies needed to improve education and create jobs with high value-added. This in turn requires a stronger institutional framework than many countries currently have in place.

B. Demographic Trends among Indigenous Groups

Given USAID's longstanding, deeply rooted concern with equitable growth and development in the LAC region, this study also looked at the prospects for greater social and economic inclusion of the region's indigenous and minority groups. Indigenous peoples in the region, in fact, are experiencing rapid changes in their livelihoods and land use.[4] Wage employment, market-based agriculture, and migration to cities are replacing traditional livelihoods (subsistence agriculture, hunting, fishing and gathering of forest products). These changes hold important implications for the future economic and social status of indigenous groups, and are critical to understanding how the groups might be helped through public policy or foreign aid. The shifts also hold potentially key implications for use of land and other natural resources in countries with large indigenous populations still residing in high biodiversity areas.

The population changes underlying the transitions that indigenous groups are undergoing are important, but relatively little understood, in large part due to a shortage of data on population increase and fertility in remote regions of the Amazon. A few key dynamics, however, are emerging with increasing certainty.

[3] Mason, Andrew. 2005. Demographic transition and demographic dividends in developed and developing countries. United Nations Expert Group Meeting on Social and Economic Implications of Changing Population Age Structures, Mexico City. Cited in Hakkert, *op cit*.

[4] Jason Bremner *et al*. "Fertility beyond the frontier: Indigenous women, fertility and reproductive practices in the Ecuadorian Amazon." Published online, 29 April 2009.

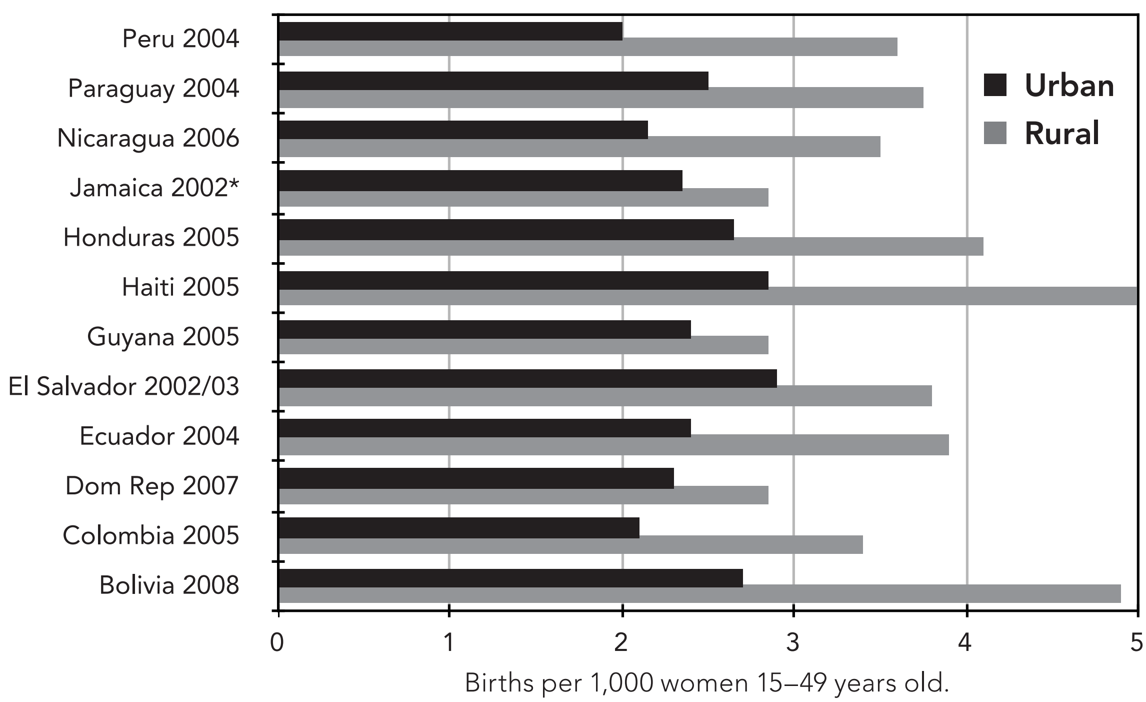
For one thing, as shown in Figure 4, fertility rates in rural areas of Latin America continue to outstrip the rates in urban areas. Rural areas, of course, are home to many — though increasingly not all — of the region's indigenous populations. And, as Bremner *et al.* (2009) note:

> "After decades of population decline, the indigenous populations of Latin America's lowland tropics are experiencing an apparent demographic turnaround. Indigenous populations in Brazil for example increased from 294,000 in 1991 to 387,000 in 2001 due to natural increase (Perz et al. 2008). McSweeney and Arps (2005) documented high levels of fertility, young age structures, and rapid population growth among more than 25 indigenous groups of the lowland tropics of Latin America."

Some but not all of the reported increase in indigenous populations stems from increased self-identification as indigenous in censuses and surveys. This has been perhaps most clearly documented in Brazil, where an additional 347,000 people reported their identity as "indigenous" during the 1990's. These developments are likely due in large measure to the increased political awareness, organization and action of indigenous groups in many parts of the region since the 1980s.

These changes in the size and location of indigenous groups hold multiple implications for public policy and donor aid that seeks to support improved welfare and access for these marginalized groups. For one thing, the reasons for the growth in indigenous populations needs to be better understood. While overall a positive development in light of the historic decline of their numbers, it may also point to the continuing low

FIGURE 4: URBAN AND RURAL DIFFERENCES IN TOTAL FERTILITY RATES



Source: USAID, 2010, Office of Population (Lindsay Stewart)

KEY TREND #2

Continued focus on ***promoting inclusion and sustainable economic opportunities for indigenous and afro-descendant communities*** is critical, as much for the regional economy as a whole as for these historically marginalized groups. The needs of socially and economically excluded groups must remain at the center of USAID's efforts.

socioeconomic status of indigenous groups, including a lack of education for indigenous women. Effective health, education and welfare improvement services remain critically important. At the same time, these services may now need to be designed for and delivered to urban concentrations of indigenous groups, with different requirements, delivery points and new links to the indigenous groups remaining in rural areas.

C. Other Minority Groups' Status[5]

The situation of minorities in Latin America is as urgent as that of indigenous peoples. The Afro-descendent population of the LAC region currently numbers about 150 million people. This is 33–39% of the overall population and far more, in fact, than the 8% (40–50 million people) who identify themselves as indigenous. The Afro-descendent group makes up fully half of the poor in the region. Together, Afro-descendent and indigenous groups comprise 48% of the overall population and 60% of the poor. Minority socio-economic conditions in the lAC region are, on the whole, deplorable. The average wage gap recorded in 2006 in Brazil for several socio-economic groups provides a telling comparison: white men earned on average R$ 1,164 or US$ 647 per year.[6] This was:

56.3% higher than white women (R$ 745 or US$ 414);

98.5% higher than black and brown men (R$ 586 or US$ 326); and

200% higher than black and brown women (R$ 388 or US$ 216)

The inadequate inclusion of these groups in education and productive jobs is not, however, detrimental only to them. One recent study estimates that the economies of Bolivia, Brazil, Guatemala and Peru could expand their GDPs by as much as 36.7 % if African descendent and indigenous populations were more included in the labor force. For social, political and economic reasons, the marginalization of these groups pulls everyone in the region down.

The fate of the indigenous and the Afro-descendent populations are, in fact, intertwined. In many regions, the two populations have merged or closely share space and cultural features. The Garifuna of coastal Central America and the Palenque or Quilombo communities in South America offer examples of where the Afro-descendent and indigenous populations and cultures have combined. Programs and policies designed to improve one group's status can often generate benefits for the other.

[5] Judith Morrison, Inter-American Development Bank, PowerPoint presentation, "Benefits of Diversity: Costs of Exclusion in Latin America." March 2010.
[6] Marcelo Paixao and Luis Carvano, "Relatorio Annual das Desigualdades Raciais no Brasil, 2007–2008." LAESER, Rio de Janeiro, 2008, pg. 103.

3.2 KEY ECONOMIC TRENDS

Current assessments of Latin America's economic growth and development prospects by and large are optimistic, if guardedly so. One recent analysis offers the following rosy summary:

> "With variations across countries, Latin America's economic agenda will change over the next few years. Fiscal policy will be monitored more independently, and may lean more against cycles. Financial regulation will be heavier, and less attuned with a single international model. Innovation will be at the center of trade strategies. Equity will begin to replace equality as the driver of social programs. More state agencies will be managed by results, starting the long process of earning citizens' trust. The region will play a larger global role, led by Brazil. And if the world's economy holds, most Latin Americans will be on a faster development path."[7]

More detailed examination of both external and internal economic issues provides additional insight into the likely dynamics in the region, the challenges it faces, and the opportunities on which it can build towards a better future.

A. Recovery from the global recession

Despite significant economic decline brought on by the global financial crisis in 2008 and 2009, the region is beginning to show early signs of economic recovery in 2010. Disagreements exist over how deep and how fast the recovery will be, and whether it will be sustainable. However, there is general agreement that economic growth will return to the region in the near future if the global economy continues to expand as well. This sentiment was summarized by the World Bank's chief Latin America economist, "The worst seems over but fragilities remain."[8]

These "fragilities" are both external to the region, including the sustainability of the global recovery, and internal, such as generally low levels of competitiveness, low standards of education, environmental concerns, and weak governance. Together, these pose long-term challenges to the economic health of the region.

Externally, uncertainties still abound about economic recovery in the United States, and more recently in Europe where concerns about spreading financial turmoil have begun to unsettle other parts of the world economy. There are also uncertainties in the global energy market, with questions about the sector's capacity to meet global recovery and the demand for fossil fuels.

Interestingly, despite the severity of the 2008 and 2009 recession experienced in the LAC region, several countries weathered the economic storm rather well and are poised to post impressive gains in 2010 if the global recovery is not subverted by uncertainties in Europe and the United States. By employing sound macro-economic policies, including fiscal and monetary restraint, LAC economies in general are likely to recover more quickly and robustly than in the past. For example, contrary to previous economic crisis, most LAC countries did not try to spend their way out of recession or nationalize banking systems. Rather than ballooning fiscal imbalances and increased foreign debt, the region managed to hold the line on spending at a much better rate than developed countries such as in the European Union and the United States.[9]

As a result, in a climate of guarded optimism, the region emerges from the global crisis well positioned to return to growth if the global economy continues to expand. The United Nations Economic Commission on Latin America

[7] A Brave New World for Latin America, Marcelo M. Giugale. World Bank, *Economic Premise* no. 10, April 2010.

[8] "Update on the Crisis: The worst is over. LAC poised to recover." Augusto de la Torre, Office of the Chief Economist. Latin America and Caribbean Region. World Bank. September 2009.

[9] Ibid.

and the Caribbean (ECLAC) predicts an average rate of GDP growth for the region of 3.8% between 2010 and 2020. Other economists predict growth of 4% to 5% in 2010.[10]

B. Global trade

After roughly two decades of decline, Latin America's share of world exports stabilized during the 2000s at approximately 5.5%. Much of the improvement is attributable to high prices for agricultural, mineral, and hydrocarbon exports. Conversely, the sharp global economic contraction in 2008 and 2009 resulted in falling global commodity prices which, in turn, led to a significant decline in the value of the region's exports in 2009.[11]

Nevertheless, early indications are that the decline in global trade, and LAC's share in it, may be easing as larger emerging economies post impressive growth rates and industrial output expands, once again increasing demand for LAC primary products. Asia, in particular, is leading the way with several economies expanding at a brisk pace of 8% to 9% annually. Brazil also is becoming a larger factor for economic growth, especially in South America. Together, industrial production in Asia and Brazil expanded an impressive 18% during the first half of 2009, exceeding the world average and the output of advanced economies.[12]

Not surprisingly, then, South American countries with strong trade ties to Asia — China in particular — and Brazil are recovering faster than those most closely tied to the United States, where decreased demand for agricultural commodities, assembled goods, tourism services, and falling remittances will limit near-term growth potential in Central America, the Caribbean and Mexico.[13]

The LAC region's economic prospects may be complicated if the rate of expansion in Asia proves to be unsustainable, or if Asia-LAC trade disputes over dumping and currency policies are not resolved amicably. For example, Argentina has imposed anti-dumping tariffs on several Chinese products and the perception of an undervalued yuan has become an irritant for many LAC economies rendering their exports less competitive by comparison.[14]

C. Global recovery means increased demand for LAC commodities

Assuming that the global economic recovery continues to take hold, it will likely mean increased demand for LAC's natural resources, agricultural commodities, services and manufactured goods. For example, continued Chinese growth will translate into increased demand for the region's natural resources and fossil fuels. The table below shows that phenomenon was already well underway before the recent recession. Primary product exports from LAC to China grew steadily from 2002 to 2008 when they reached 60 percent of total trade. There is every reason to believe this trend will continue as China and other Asian economies, like India and the so-called Tiger nations, and Brazil continue to expand rapidly.

But the news is not all good. Despite the potential short-term benefits, there are also long-term risks to the region posed by a recovery based primarily on the export of primary products and fossil fuels.

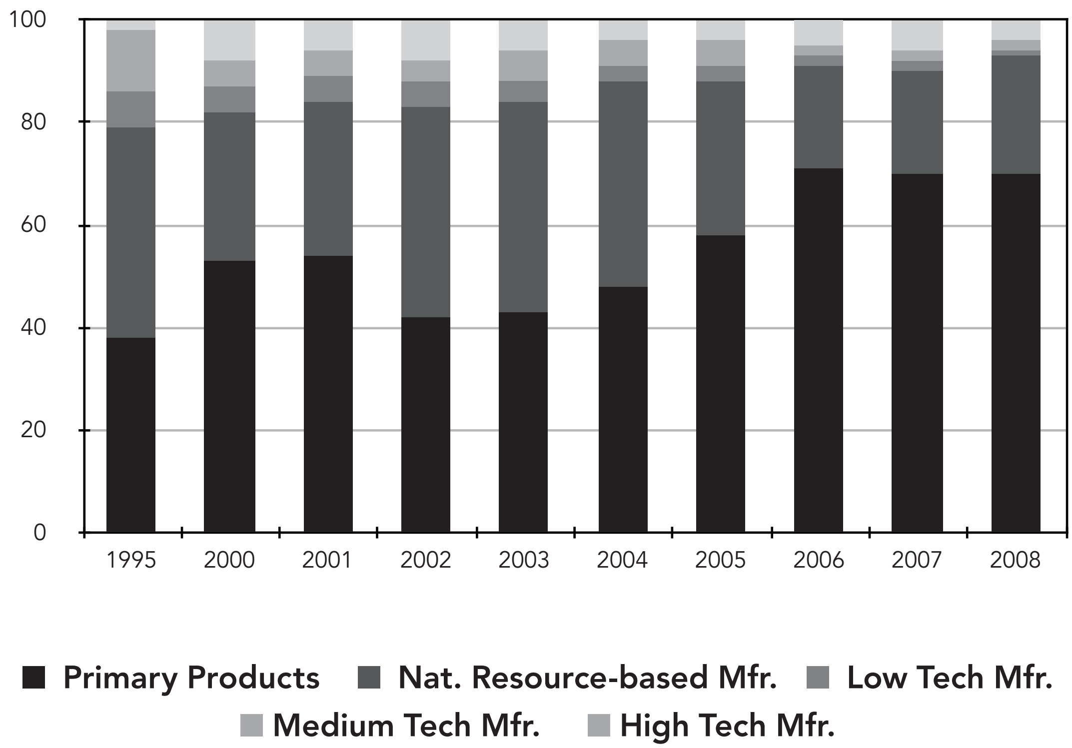
For example, economies based on natural resource exploitation, primary products, and extractive industries often suffer from limited global competitiveness in other more profitable

[10] World Economic Forum on Latin America. Conference report: "New Partnerships for a Sustainable Recovery." Pg. 17. Cartagena Colombia. April 2010.
[11] "Recent Trends in External Trade Patterns in Latin America and the Caribbean." Commission paper by Clarence Zuvekas Jr., Consultant, Chemonics. March 22, 2010.
[12] Op.cit. de la Torre, World Bank.
[13] Op.cit. de la Torre, World Bank.
[14] Proceedings from World Economic Forum on Latin America, April 2010

KEY TREND #3

The LAC region (South America, in particular) is experiencing ***tighter integration with the Chinese economy and markets***. This growing economic relationship is based primarily on the exchange of primary products and commodities from LAC in return for manufactured goods from China. Such a relationship increasingly poses a challenge to governance in the region as economic growth based on purely commercial exploitation of natural resources and commodities comes into conflict with commitments to sustainable resource management and the well-being of rural and primarily indigenous and afro-descendant populations.

FIGURE 5: LAC EXPORTS TO CHINA



Source: *"La República Popular China y America Latina y el Caribe: Hacia una relación estratégica."* CEPAL, April 2010.

sectors such as manufacturing and technology. Further, rural populations, especially indigenous and Afro-descendant, often do not benefit directly from extractive industries even though their lands are sought after for their rich natural resources. Worse, recent experiences in Peru, Guatemala, Honduras and Mexico suggest that heavy reliance on extractive industries can lead to greater social conflict between marginalized populations, industry, and government.

An additional factor in the natural resource-based economic relationship with China is that Chinese investments are mostly negotiated between sovereign nations and therefore are not subject to the environmental and social impact assessments and other considerations that may be required of other multilateral lenders or investors. Chinese investments in the development of natural resource fields come with relatively few strings attached and potential environmental or social impacts of such investments on indigenous or Afro-descendant populations in the region may not be a priority.

D. Global recovery may lead to increased energy costs

According to the World Energy Outlook 2009, primary world energy demand will increase significantly between 2010 and 2030 with most of the demand coming from non-OECD countries, especially China and India. "Non-OECD countries account for 93 percent of the increase in global (energy) demand between 2007 and 2030."[15] Furthermore, 77% of the world's increased demand for energy will be in fossil fuels, with nearly all this increase happening in non-OECD countries.

There is also evidence that the economic decline of the past two years led to declining investments in exploration, infrastructure, and production capacity for fossil fuels. While increases in long-term energy demand will likely bring back investment to the sector, prices might experience an even steeper increase in the short run as demand outstrips capacity and the investment lag time makes meeting the new demand difficult.

In both cases, however, the price of energy is likely to increase in the coming years, adding an additional burden to the net energy importing countries of the Caribbean and Central America.

While increased demand for fossil fuels, natural resources, and agricultural commodities will benefit some of LAC's energy and agricultural exporting nations, there is a significant downside to this development model in terms of greater pressure on the environment, increased risks from global warming, and demand for land. For instance, a growing middle class in Asia has resulted in subtle changes in diets, resulting in increased demand for high protein commodities, especially meat. Greater demand in Asia for meat has translated into greater demand in the LAC region for pasture lands and soy production to feed cattle. These demands have brought new pressures to expand deforestation, potentially resulting in locally or regionally declining rainfall and even desertification. Similarly, continued exploitation of natural resources and global dependence on fossil fuels contributes to greater global warming and ultimately raising sea levels and increasing vulnerability to natural disasters. These factors are particularly worrisome for Caribbean basin countries whose main source of foreign exchange — tourism — could be at risk if popular destinations are threatened by rising sea levels and coastal erosion.

In addition to the potentially negative environmental impacts of a commodities-led recovery, there are also serious potential human costs of such a strategy. Minority and traditional populations that are culturally tied to traditional forms of land usage and ownership

[15] World Energy Outlook 2009. Presentation to the Press. November 2009. International Energy Agency.

could find themselves either displaced or marginalized by growing demand for their lands for agriculture, tourism, or subsoil resources. Increased demand for arable land, forestry products, mining, and tourism already have threatened the traditional livelihoods and cultural identity of indigenous and Afro-descendant populations across the region.

3.3 INTERNAL ECONOMIC ISSUES

There are several non-economic factors that also will impact economic growth and productivity significantly in the region in the coming years. Good governance, or the lack there of, is undoubtedly one such factor. Governance is the ability of the state to effectively and efficiently manage its affairs, provide services in an equitable and efficient manner, and guarantee a level playing field for access to justice, education, and economic opportunity, amongst others. Good governance is essential to a well functioning economy that depends on the state to enforce contracts and regulations in an evenhanded manner. Conversely, the absence of good governance generally denotes an inefficient, unreliable state that might be deeply penetrated by corruption and lacks legitimacy in the public's eyes. As such, the absence of good governance can be dissuasive to potential investors, both internal and external.

One significant manifestation of the absence of effective governance is the growing problem of crime and violence throughout the region. Drug trafficking organizations and organized crime groups in particular have taken advantage of weak governance to co-opt the state and protect illegal activities. As organized crime penetrates the state, it usually weakens the state's capacity to fight crime, reduce and prevent violence, and regulate licit financial and commercial markets that are overwhelmed by illicit goods and services. By creating so-called "black markets," organized crime undermines legitimate commerce and weakens economic growth.

Additionally, the region-wide increase in crime and violence over the last two decades has contributed to greater feelings of insecurity in the public, and challenged the capacity of the state to fulfill its most basic responsibility to the public — providing security to its citizens. High crime rates and an ineffective state response erode the public's confidence in law enforcement and judicial institutions which, in turn, can create a spiral of more crime and insecurity.

Together, weak governance and low public confidence in the state are a major drag on investment and economic growth in the region, especially where competitiveness is undermined by corruption and the state lacks legitimacy in the public's mind.

These factors are particularly worrisome in smaller economies where indicators of crime, violence, and corruption are highest. For example, according to the United Nation Development Program, Central America is now the most violent region in the world with an average rate of 33 homicides per 100,000 inhabitants.[16] Central America's northern triangle is particularly violent, with Guatemala registering a homicide rate of 45, El Salvador at 49, and Honduras at 58 per 100,000, the highest. The Caribbean is also experiencing high levels of violence with the Dominican Republic at 23.5, Trinidad and Tobago at 24, and Jamaica at 49 per 100,000.

While it is difficult to estimate the exact economic impact of violence, high levels of insecurity definitely have an impact on human capital in terms of lost opportunities when young people are killed, do not pursue education and training, are caught up in gangs or trafficking, or simply migrate to escape the violence. This, in turn, further discourages foreign investment.

[16] "Opening spaces for citizen security and human development. Main Findings and Recommendations." Human Development Report for Central America, HDRCA 2009–2010.United Nations Development Program.

There are also serious underlying social and educational challenges that contribute to elevated crime rates and threaten productivity gains. As one recent study noted, "Latin America remains the most unequal region on earth. Inequality dominates virtually all its development outcomes—income, educational achievement, landownership. Taxation and public expenditures have made little difference in addressing the problem."[17] Poor education and a lack of investment in infrastructure will make it harder for the region to increase domestic productivity. In addition, Latin America ranks near the bottom in surveys on the quality of its schools.

According to the OECD's 2009 Economic Outlook for the LAC region:

> "GDP forecasts for 2009 and 2010 combined with well-accepted measures of the link between poverty and growth suggest that poverty could increase by close to seven percentage points by the end of 2010. This translates into almost 39 million people newly falling below national poverty lines and would almost entirely reverse the progress made during the five years before the crisis. Poverty reduction, of course, does not come only from growth but also from effective social policies broadly construed. Unfortunately, those countries that have made significant redistributive gains — notably Argentina — now lack the resources necessary to maintain the policies behind these gains."

Finally, the absence of good governance also has a dramatic impact on the cost of doing business in the region. Lack of transparency and accountability in the judiciary translates into greater corruption which can mean greater uncertainty about contract enforcement and dispute resolution in commercial, investment, and intellectual property cases. Furthermore, poor governance often translates into a tangled knot of contradictory regulations that are costly to implement and impossible to challenge. Likewise, "red-tape" associated with starting a new business can be a powerful dissuasive to investment and innovation. According to the World Bank's 2010 "Doing Business" survey, many of the region's largest economies are ranked low on ten indicators measuring the business environment. Brazil and Argentina, for example, are in the bottom third of the survey, while many more in Central America are in the bottom half. Interestingly, the economies of the Caribbean generally rank higher, with relatively low restrictions on starting businesses and more certainty in contract enforcement.[18]

3.4 CLIMATE CHANGE IMPACTS

ECLAC recently offered a high level summary of predicted climate change impacts in the region:

> "Climate projections for Latin America and the Caribbean indicate that the average temperatures will continue to rise gradually but persistently and at different rates across the region and that there will be changes in the volume, intensity and frequency patterns of precipitation. Climate will become increasingly variable, and the incidence of extreme temperature events, such as heat waves, will therefore increase. Average temperatures [are] projected to rise across South America by between 1°C and 4°C under the lowest emissions scenario and between 2°C and 6°C under the highest-emissions scenario.
>
> Precipitation projections are more uncertain for the region. Rain forecasts for the

[17] A Brave New World for Latin America, Marcelo M. Giugale. World Bank, Economic Premise, April 2010, no 10.
[18] "Doing Business 2010: Reforming Through Difficult Times. World Bank Group, IFC, 2009.

> central and tropical regions of South America range from 20–40% drops in rainfall to 5–10% increases from 2071–2100.
>
> Almost all the climate projections suggest a steady increase in extreme weather events. Rainfall will most likely increase over central Mexico and the tropical and southeastern parts of South America. Climate models reveal a 10% average increased and a rising trend in precipitation in north-eastern Ecuador, Peru and south-eastern South America, with a drop in rainfall in eastern Amazonia and the north-east of Brazil, the central-northern parts of Chile and most of Mexico and Central America. Droughts will tend to increase in Mexico, Central America and all of South America (except Ecuador, north-eastern Peru and Colombia). Although the intensity of precipitation is expected to increase in general in Latin America and Central America, dry periods will be come longer and average precipitation levels will drop. Heat waves are expected to become more and more common across the region, especially in the Caribbean, south-eastern South America and Central America."[19]

Overall, ECLAC estimates that the need to address and deal with the most likely impacts of climate change will cause a reduction of GDP and per capita GDP rates in the region, although the estimated decreases vary widely across countries. ECLAC's estimates are based on a calculation of the difference that climate change impacts will cause between a "business as usual," historically based projection of GDP and per capita GDP growth rates and what can be expected once the net costs of the climate change impacts are taken into account.

These highly aggregated data, however, mask a wide array of possibly major impacts at the sub-regional, national and local levels throughout most of the region. The three most significant overall impacts are likely to be changing rainfall patterns and hence water availability; expected sea level rise; and an increase in the number and intensity of extreme weather events. Each of these impacts already can be seen in some part of the region and each calls for significant adjustments, investments and institutional changes. The ECLAC study summarizes the expected results of these three key impacts as follows:

A. Changing Precipitation Patterns

Areas of South America that are currently relatively dry will experience a decrease in the availability of water. A decrease of up to 30% in annual rainfall may be observed as a result of a 2°C increase in global temperatures, while a decrease of up to 50% in annual rainfall could result from a 4°C temperature increase. Such damages will substantially increase the number of people in the region who have difficulty accessing clean water in 2025. Some areas of Latin America are expected to experience severe water stress, which will affect the water supply and hydroelectric power generation, particularly in the Andean countries and in Brazil. In addition, many glaciers in the Andes are expected to disappear within the next 15–20 years, which will cause water shortages — including to some large urban areas — and may also strongly impact hydropower generation.

Under almost any climate scenario, Central America is expected to face serious new water problems, particularly on the Pacific slope side of the isthmus. Salt intrusion into coastal aquifers will affect water quality for irrigation, household, and even industrial use (bottling). The region will thus face rising problems with water quality as well as quantity — all this in the face of rising demand.

[19] ECLAC, Economics of Climate Change in Latin America and the Caribbean — Summary, 2009

The countries of the Caribbean sub-region will face reduced availability of fresh water as well, although some projections show a rise in rainfall due to greater variability in precipitation. Overall, however, the number of dry days and the frequency of drought are both likely to increase. Cloud cover also will likely increase due to shifting climatic patterns, with implications for tourism and possibly agriculture.

B. Impact of Sea Level Rise on Coastlines

The rise in sea level will increase the numbers of people displaced and land lost to permanent flooding, among other issues. Small Caribbean islands will be strongly impacted as well as much of the Pacific coast of Latin America. Mangroves — a highly productive ecosystem, tied in with the salt water-fresh water exchange in many areas — may disappear in locations as diverse as northern Brazil, the Pacific coast of Colombia, and the shrimp farm regions of coastal Ecuador and Guyana. The coastal areas of the River Plate, in Uruguay and Argentina, also are seriously threatened, due to a rising intensity of storm waves and rising sea levels. Shipping and overall port operations in that area will also be affected.

C. Extreme Weather Events

The countries of the region will be strongly affected by extreme weather events, from droughts (such as one currently under way in the Caribbean) through hurricanes and floods. ECLAC estimates that by 2100 the cost of extreme weather events, in constant 2008 prices, will move from an annual average of about US$8.6 billion (for 2000–2008) to (i) US$11 billion at a 4% discount rate; (ii) US$ 64 billion at a 2% discount rate; and (iii) US$250 billion at a 0.5% discount rate.

The costs of the impacts from climate change are potentially high. As an example, one World Bank estimate for the cost to CARICOM countries by 2080, reaches $11.2 billion in 2007 US$.[20] This sums to 11.26% of the region's GDP. Of this, the greatest loss ($4.9 billion) derives from weather-related disasters such as hurricanes and floods. Temperature rises, with their effect on tourism in particular, contributes another estimated $4.0 billion. Sea level rise, agricultural losses and the costs of additional water supply account for most of the rest.

Looking at the projected impacts from expected climate change in just one important sector sheds additional light on the extent, severity, variability, and economic and social impacts of these trends. The ECLAC analysis provides a telling glimpse into the future of LAC agriculture, with multiple variations and non-linear paths across the region:

i) In the Southern Cone region, Argentina, Chile and Uruguay likely will see average temperatures rising by 1.5–2°C between 2030 and 2050. These higher temperatures may at first contribute to a rise in farm yields compared to current levels. However, if temperatures increase beyond this level, the overall effects on agricultural production will be negative. And even temperature increases in the lower range may result in spread of pests and diseases and decreased irrigation water supplies due to melting glaciers, ultimately pulling farm productivity down.

ii) In Ecuador, the effects of projected climate change will vary by farm sector and crop. For subsistence farms, yields may rise due to a 1°C temperature rise, but this would be reversed once the 2°C threshold is crossed. A 1°C increase would reduce banana, cocoa and plantain production on intermediate farms.

[20] De la Torre, Augusto, et al. Low Carbon, High Growth: Latin American Responses to Climate Change, Annex 2. The World Bank, Washington, D.C. 2009.

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Climate change is already having a discernable impact on the economies and peoples of the region, and it will continue to do so. Both climate change mitigation and actions to build resilience must be urgently stepped up.

iii) For the Caribbean, climate change projections suggest that higher rainfall would likely raise farm production in Guyana, but yields in nearby Trinidad and Tobago could fall due to more farmland flooding. In the Dominican Republic and the Netherlands Antilles, rising temperatures would benefit agriculture as a whole, at least up to a certain threshold. In general, rising temperatures are not expected to affect sugar cane production much at all, while crops such as plantain, cocoa, coffee and rice are more susceptible.

iv) Soil degradation, both due to harsher cycles of drought and flooding as well as to poor farming practices, will be a serious problem across the region. By the year 2100, 66% of farm soils in Paraguay are likely to be seriously degraded and as much as 62% in Peru.

An additional set of significant costs, related in some but not all ways to agriculture, stems from the potential for major biodiversity losses to follow shifts of rainfall patterns and temperature gradients across the landscape. Both the Amazon and the Andean piedmont regions of Latin America are hot spots of biodiversity, with extraordinary, globally important levels of endemism and beta-diversity, especially on the slopes of the Andes. Much of current existing biodiversity would be lost or at least geographically moved over time due to climate change. The consequent harm to ecosystem stability and functionality will generate costs of adjustment in agriculture, water management, and landscape productivity, as well as unknown costs in loss of genetic material and plant interactions. Intangible costs from the loss of familiar landscapes will also be real, though very difficult to value. In general, costs due to biodiversity loss are a potentially large item whose valuation goes beyond the normal cost-benefit methods used in economic analysis.

Increased socio-political instability and conflict pose yet another major challenge and multi-level set of costs due to climate change. Severe weather events — in some cases leading to catastrophic losses and challenges to governments' ability to cope — are a particular area of concern. The U.S. Department of Defense's February 2010 *Quadrennial Defense Review* states that "climate change, energy security, and economic stability are inextricably linked" and that climate change and natural disasters will "act as an accelerant of instability or conflict, placing a burden to respond on civilian institutions and militaries around the world."

3.5 SUMMARY OF CONTEXT

In sum, the countries of the LAC region stand before an historic opportunity to improve their welfare over the coming 5–10 years, given the ongoing age structural transition (AST). At the same time, their ability to grow and to take advantage of the AST has been limited to date and seems likely to continue to be hobbled by poor governance and weak policies for education and job generation. And the sizeable indigenous and minority populations are not yet experiencing the AST, a telling fact that speaks to the deep extent of their continuing exclusion from economic benefits and social advancement throughout the region. Furthermore, serious problems of national-level governance link to broad issues with corruption, drug trafficking and urban governance. Last but not least, the region faces a potentially severe challenge to growth, governance and economic sustainability from climate change impacts during the coming decade and beyond. Each of these factors suggests areas in which USAID can consider useful programming in the region during the coming decade.

Section Four

Focal Areas for USAID Work

Within the overall context of the LAC region, USAID needs to choose priority areas for programming and general engagement. The final selection of focal areas needs to take into account at least the following factors:

- What are national government and NGO priorities?
- Which national priorities are other donors already funding?
- What are US government priorities for support, engagement and leadership in the region?
- Where does USAID have capacity and expertise? That is, which lines of engagement build on existing USAID programs and institutional strengths?

The current exercise has not systematically analyzed all these factors. However, existing information on each has been reviewed during this process and the resultant thinking on these variables is presented below.

In general, USAID has sound programming bases in most of the key areas identified below. Engagement in these areas to take advantage of the opportunities described in Section III above is more a matter of re-orienting or intensifying programs rather than starting something entirely new. Managing the transition from existing to new programming also is an important consideration. Annex 1, the "Matrix for Determining USAID Regional Focal Areas," provides a schematic for issues that need to be taken into account in the transition.

4.1 KEY INITIAL ISSUES

Information about country government and civil society priorities is available from sources such as U.S. Government Embassy and Mission communications with counterparts, from Organization of American States' statements of interest, and from governments' public statements. At the start of the trends analysis exercise, USAID mission staff identified five themes as particularly important to equitable growth and environmental sustainability in the LAC region over the coming five to ten years. Their choices were based on perceived importance of issues and incorporated expressed government and civil society priorities along with other variables. The themes are:

- Climate change and energy issues
- The special challenges of the region's small economies
- Indigenous and minority issues
- Urban governance issues
- Inequality and access to resources: how to achieve more equitable, sustainable growth

Over the course of the literature review and expert consultations for this project, the first four of these issue areas came to be seen as particularly important areas for new or redoubled USAID programming efforts. Because achieving more equitable and sustainable growth remains a critical, cross-cutting issue, it also will be discussed as a continuing area of programming. Consequently, the remaining sections of this paper will focus on describing these last four categories more specifically and will point to ways that USAID could support socially and economically equitable development, with environmental sustainability, while working in these programmatic areas.

4.2 ADAPTATION TO CLIMATE CHANGE

Adapting to the impacts of climate change may be the greatest, most far-reaching challenge for all countries of the region in coming years. As rainfall and water availability, coastal and marine resources, and even soil conditions shift due to changing weather, every nation will need to reconsider its use of energy and basic natural resources. This, in turn, implies the need for a country to reorganize its basic economic activities, such as agriculture, industry and transport. The changes called for are massive, ranging from developing better early warning systems on looming severe weather events, through planning for resilience of natural systems and human infrastructure, to increasing international cooperation. Very importantly, changes also will be needed in governance systems. The potential for displacement, loss of livelihoods and lives is great, and can lead to pressure on political systems. Not only broad participation in designing and executing plans for resilience, but also improved coordination across government levels and agencies will be crucial.

Over the next 30–50 years, countries urgently need to define and act to increase adaptive capacity. But what kind of capacity is in fact needed? Experts have noted that adaptive capacity is very difficult to measure because it's a latent measure — countries generally do not know if they have capacity until an emergency or disaster hits. Capacity also is dynamic through time, sector and scale. It cannot be said that either the rich or the poor are always less vulnerable, but the assumption that the poor are less vulnerable and more resilient because they have less to lose can be particularly damaging. In addition, while technical information is clearly needed, it cannot be the only input provided for public discussion, because overly technical language can be a barrier to broad participation in debates on what is needed to address climate change. In short, the most robust response is for countries to invest more in generic adaptation capacity rather than focusing on sector-specific measures. This broader approach requires better coordination across all relevant government agencies and mainstreaming of climate change concerns.

Because adaptation is so encompassing an issue and because so much work remains to be done, fruitful areas for USAID engagement are many. Some of the key areas identified during expert consultation on adaptation included the following:

- **Exploring the prospects for partnerships between the private sector, USAID and government agencies to develop better technical information on climate change impacts, based on practical project experience**. Because climate change won't likely be a linear process, much more data is needed about how it is occurring.
- **Helping to integrate the various early warning systems, hydroestimators and other environmental data systems USAID has supported in the past into more decision- and policy-oriented tools.**
- **Supporting the ability of government agents to take in, act on, and coordinate initiatives around the resultant data.** Both governments and foreign aid agencies must recognize that information (or lack thereof) on climate change will drive investment in the private sector and that adaptation will not be financed in its majority by foreign assistance, but by the public and private sectors in each country. Information and coordination is needed for these sectors.
- **Focusing on improving government agency coordination around climate change issues.** In particular, the economic, agricultural and industry ministries of most countries in the region need to engage on this issue in addition to and in coordination with the environment ministries. At the same time, there is a need to bolster the capacity of the region's technical staff who work on environmental indicators and climate change policy. Too often, climate

change offices are one-person shops, with little capacity or political support.

- **Investing, alone or with other donors, in a set of small adaptation pilot projects.** To play out effectively, adaptation needs to be a dynamic, scientifically based and monitored process. Pilot projects, launched in a timely manner and organized in key sectors and regions could serve to test hypotheses about adaptation and generate information. Such pilots may take from 5–10 years to generate useful results, but if launched in the near future, could be a productive early step in collecting the data and building the awareness that will be needed.

- **Improving government standards for the environmental and social impacts of large infrastructure projects to include better planning for resilience.**

- **Exploring and strengthening the fundamental linkages across adaptation, peace and democracy.** The transparency of and participation in designing and using information about climate change will be critical to making all sectors of society feel that their concerns with regard to climate change are being addressed. It also will be important to ensuring that the costs of adaptation are equitably shared across social sectors, government, and the private sector.

4.3 CHALLENGES OF SMALL ECONOMIES

The smaller economies of the Latin American region — largely countries in Central America and the Caribbean — continue to face special and at times daunting challenges to their ability to grow and improve citizen welfare.[21] Country size is important because small economies with tiny domestic markets need to be open to the world economy to have good prospects for strong and sustained economic growth. Openness began to increase with varying degrees of speed in response to the Latin American debt crisis of the early 1980s and the ensuing "lost decade." At the same time, openness makes small countries especially vulnerable to the vicissitudes of the world economy, especially if they are heavily dependent on trade with one country, as many in both Central America and the Caribbean are with the United States.

The nations of Central America and the Caribbean are much smaller in geographic area and population than the countries of South America. The combined population of the seven countries in the Central American region was 41.8 million in 2009. Country populations ranged from 0.3 million in Belize to 14.0 million in Guatemala; the other countries each had between 3.5 and 7.5 million inhabitants. The Caribbean region had 24.3 million people in 2009. Haiti and the Dominican Republic accounted for 81% of this total, in roughly equal proportions. At the other extreme, the average population of the six Eastern Caribbean countries was below 100,000 persons.

Within Central America, per capita GDP in 2008 was highest in Panama ($5,688 in 2000 prices) and Costa Rica ($5,189) and lowest in Nicaragua ($897), which has been struggling to recover from a sharp plunge in output during the 1980s. The unweighted average GDP growth rate in the region was a solid but not spectacular 4.3% between 1990 and 2000 and 4.5% between 2000 and 2008. In the Caribbean, 2008 per capita GDP figures (in 2000 prices) ranged widely from $11,601 in Antigua & Barbuda to only $391 in Haiti. As these data indicate, the status of the small economies in the region ranges from moderately good in countries such as Panama and Costa Rica to poor as in Haiti.

21 Data in the next two paragraphs is from Clarence Zuvekas, "Prospects for Economic Growth in the Central American and Caribbean Countries: A Brief Concept Paper." Chemonics, 6 April 2010.

Small group discussions of Caribbean and Central American Mission staff during the conference in Panama confirmed that the following key areas for future growth and welfare improvement in these countries would be important for USAID engagement, and in many cases would build on existing work:

- **Improving education systems** — the highest level of educational attainment in the region is recorded in Panama, where children attend school for an average of 8.3 years (as of 2000). Even Costa Rica trails behind with an average of 6.1 years; the lowest number of years in school is consistently registered in Haiti, with only 2.7 years of schooling on average. Throughout the region, quality of education remains poor. Improving both the number of years of schooling and the quality of the education imparted is critical to raising the abilities of this region's labor force, and its prospects for integrating into the world economy in new and innovative ways. Although USAID's economic growth and environment programs do not necessarily focus on education, this project has highlighted the need for cross-sectoral collaboration with the latter in order to achieve development goals in the former.

- **Reducing national debt burdens —** many LAC countries, particularly those in the Caribbean, continue to suffer from debt-to-GDP ratios greater than 100%. The burden of repaying this debt stifles the governments' ability to invest in social and economic improvements such as infrastructure. Some form of relief from the debt — and certainly some way to ensure it doesn't continue to grow — would be critical to allowing these countries to advance. In particular, restructuring the relation between big state enterprises and government might be a key factor here. In several cases throughout the region, large state enterprises have taken on debt, later passing this burden on to the government when they found themselves unable to repay it. USAID, through the Bureau for Economic Growth, could consider reinforcing national level work in key countries that examines taxation policies and seeks to rationalize them. This could build on and complement work already under way by the Inter-American Development Bank.

- **Addressing crime —** organized crime, often linked to illegal drug trade, reaches into many parts of the economy and often to high ranks of the government in many countries of the region. This has led in some countries to "capture" of the government by organized crime, with serious consequences for transparency and citizen security. In several countries, it discourages tourism and even investment. USAID's role in this issue might be best designed through its Governance and Democracy programs, in collaboration with Department of State and other US government agencies engaged in combating corruption in the region.

- **Strengthening national capacity to mitigate and adapt to climate change impacts —** as summarized earlier, the islands of the Caribbean already face quite serious climate change impacts, chiefly due to sea level rise and extreme weather events. To help address these, USAID already is exploring ways to establish or strengthen early warning systems in the Eastern Caribbean. Work to strengthen land use planning, improve and enforce building codes, and tighten coordination across government agencies for addressing disasters would be critical as well.

- **Maximizing benefit from trade** — contrary to many analysts' views, lack of market access may not, by and large, be a key problem for the countries of Central America and the Caribbean. The real challenge the countries face is organizing their production and export systems to be able to take full advantage of the trade benefits they already have. Use rates of several trade agreements is notably low, ranging from just 12% for the CBI, through 5% of CARICOM and zero of the Economic Partnership Agreement with the EU. Trade facilitation, shipping integration, and lower transport costs are key elements to moving more current products out of the region.

Current exports from Central America and the Caribbean are chiefly alternative agricultural products, such as coffee, tourism services, and the value-added from *maquila* operations (though these increasingly are being moved to South East Asia). Diversification and development of higher value-added products and services are critical for advancement. Retirement medicine, sports medicine and "low carbon" (sustainably-produced) rum are examples of new products and services that can be considered for development. Both this issue and the one of limited export are under-examined and open the opportunity for USAID to explore support for streamlined export systems and alternative, high value products.

- **Seeking alternatives to high energy costs —** One of the highest costs of production and certainly of export in the Caribbean and Central America is energy. Much of industry and processing and virtually all transport rely on imported oil. Even with better organization of trade and new products, this factor would keep the region at a disadvantage for trade and development. And, with energy demand exceeding supply in the region since 2006, prices are likely to rise higher in the foreseeable future.

  At the same time, Central America and even the Caribbean have enormous potential for renewable energy generation. Guyana, for example, has two major rivers whose hydropower, if harnessed and transmitted to the islands, could provide power for much of the Eastern Caribbean. Waterfalls in Jamaica could similarly provide a large share of the electricity needed on the island. Solar power potential also is great, even with current prices of photovoltaic cells and solar panels. USAID's clean energy funding in the region should be open to the development of these renewable sources, and support their access to the region's electricity grids at competitive prices.

- **Supporting regional coordination on Haitian development** — Haiti's recovery and development are too often considered only as a Haitian issue and as depending only on Haiti's resources and capabilities. In fact, it may be more appropriate and beneficial to both Haiti and to the Caribbean as a whole to think about Haitian development as a coordinated task of the whole region. This allows planning for energy and labor flows in more flexible ways across countries, rather than placing all the burden of recovery and development on Haitian capacities alone. Given USAID's key coordinating role in recovery and reconstruction plans in Haiti, it would be important to build this broader regional approach into planning and guidance there.

4.4 INTEGRATION OF INDIGENOUS AND MINORITY GROUPS INTO ECONOMIC, SOCIAL AND POLITICAL SYSTEMS

Key areas for USAID engagement on indigenous and minority issues include the following, identified during the expert consultation:

- **Helping develop more basic data on the numbers and status of both indigenous and Afro-descendent minority groups**. Data on even the numbers of indigenous peoples, much less their population fertility rates and health status, are by and large very spotty throughout LAC. This is complicated by the issue of self-identification. Data on minorities is even scarcer, with the exception of Brazil.

- **Providing training and capacity building for indigenous organizations**, particularly to strengthen their ability to advocate for new and exercise existing legal rights and guarantees. Such an approach can build on successes to date such as land claims in the Amazon and the Andes. There is a need to build the systems and organizations that can help indigenous populations exercise their existing legal rights effectively. For example, while laws and even the Constitution in countries such as Colombia provide for greater equality for indigenous and minority groups, exercising these rights in the courts, in land disputes, and in disputes over mining and other resource use calls for a second level of institution building.
- **Helping indigenous and minority groups engage effectively in the planning processes around big infrastructure projects**. All the IIRSA development potentially will have major impacts on their lands, and their ability to express and promote their interests in early stages of planning will be critical to managing the impacts on their lands, livelihoods and cultures.
- **Promoting effective access to and management of land and related natural resources in countries of Central America** remains a critical issue.
- **Continuing support for culturally adapted education of indigenous youth**, to support a positive self-identification. This can potentially be important particularly in urban areas, where indigenous and minority youth lacking adequate cultural support systems can tend towards marginalization and youth gangs.
- **Mainstreaming social and economic inclusion into all USAID projects**. The Agency also should consider hiring in-region staff from within the indigenous and minority population.

4.5 URBAN ISSUES — ECONOMIC, SOCIAL AND ENVIRONMENTAL ASPECTS

Over 78% of the LAC population lived in urban areas in 2007, making LAC more highly urbanized than Europe, Africa or Asia.[22] The LAC region consists primarily of medium-income countries and is also more urban than the average for high-income countries, according to the World Bank.[23]

Considerable variation still exists within the region, however, among sub-regions and across countries. For example, South America is the most urbanized sub-region (81.8% in 2005) and the Caribbean the least (64.3%). Argentina, Uruguay, and Venezuela were the most urbanized countries in 2005, with over 90% of their population living in urban areas. Guyana was the least urbanized in 2005 (27%), followed by Haiti (42.7%), Honduras (46.5%), and Guatemala (47.2%).

More recent trends suggest that the urbanization pattern in the LAC region may be diversifying. Many of the region's major cities now have lower population growth rates than smaller cities due to the more advanced stage they have reached in the demographic transition. Fertility rates are declining and the rate of in-migration that is occurring in some of these larger cities

[22] Chemonics International, "Urbanization in Latin America and the Caribbean: Trends and Challenges," Contract No. AFP-I-00-04-00002-00, Task Order No. 9. April 2010.
[23] World Bank, World Development Indicators, 2009.

is low or even negative. The trend toward the concentration of populations in a primary city, which was prevalent in the region until the 1970s, is also declining.

Meanwhile, medium size cities (defined as cities that have populations between 50 thousand and one million) have been growing rapidly, particularly during the 1980s, when their rate of growth was higher than the rate for larger cities and also higher than the rate for the urban population as a whole. In the 1990s, a number of these secondary cities began to encounter some of the same types of problems that the LAC region's larger cities long have been dealing with, such as problems related to the development of infrastructure and the delivery of municipal services. There is also some evidence that poverty is more widespread in secondary cities than in metropolitan areas.[24]

Overall, though primary rural-urban migration is tapering off, urban areas continue to pose major issues of governance, livability and sustainability for the region. Key challenges that Latin America now faces in its cities, and that USAID could seek to address, include:

- **Governance**: The cities of the LAC region are all too often concentrations of drug trading and violence. Rio de Janeiro, Kingston, and Medellin have all been renowned as highly troubled and insecure cities, with alarmingly high levels of homicides. Rio de Janeiro has at least twice been virtually shut down by drug ring invasions of its city center. These questions of citizen security and drug trafficking are dramatic challenges to municipal and even national authority in the region. They call for new models of local governance and shared problem solving among local, regional and national government agencies. A high level of meaningful citizen involvement also is essential. USAID's programming in the region on urban issues could contribute greatly by supporting the adaptation and dissemination of proven models of engagement in urban governance issues, such as the models offered by Viva Rio in Brazil.

- **Livability**: Personal security issues strongly affect the sense of livability in any urban area. But livability extends well beyond even the challenge of citizen security. Questions of poverty alleviation, delivery of municipal services, infrastructure and organization and design of space (including public space), all affect livability.

  In much of the LAC region, the largest numbers of the poor live in peri-urban areas rather than in the countryside. Their socioeconomic conditions, while presumably somewhat better than in the countryside, remain very low. The policies, programs and opportunities to reach them are by and large entirely different than the programs needed to raise the status of the rural poor, involving different state agencies and sharing of responsibilities. Municipal governments, in conjunction with other authorities, must seek effective ways to reach these groups with a higher level of support to education, health care and even nutrition than even in the more prosperous neighborhoods of the cities.

- **Sustainability**: Because they are the major concentrations of population in the region, cities draw immense quantities of key natural resources such as water and energy. Their industrial, transport and residential systems are major users of the energy needed to fuel a country's development. They thus also emit important shares of many countries' greenhouse gas (GHG) emissions

[24] ECLAC, "From Rapid Urbanization," 2000, p. 11 and p. 21.

from industry and transport. Supporting the design, development and dissemination of ways to provide needed water and fuel in lower-carbon, cleaner ways is a major new area of needed work and one in which USAID can also greatly contribute.

4.6 ACHIEVING MORE EQUITABLE, SUSTAINABLE GROWTH

For reasons widely documented in development literature, realizing the economic and social potential of the countries in the region depends heavily on the quality of their policies and of the institutional frameworks set up to implement policies. Although wide variation exists, the countries of the LAC region by and large still face great shortcomings in this regard. Important reforms are needed in the social, fiscal and finance areas. Expert consultations have pointed out several key areas for work:

- **Need for Stronger Internal Markets**: While external markets provide substantial opportunities for the region, LAC countries also need to improve their business enabling environments and stimulate domestic investment and demand. Countries in the region must work to diversify their mix of both export products and markets while incentivizing growth in promising domestic sectors which may include tourism, retail, construction, higher value-added agribusiness, certified goods, and services such as back office support. The countries of the region need to find ways to stimulate more growth in these and other sectors.

- **Increased Financial Flexibility and Innovation**: Greater access to credit and an overall higher loan to GDP ratio — is also needed. To achieve this goal, LAC countries need to broaden access to financial services, especially for small businesses and in rural areas. Advances in connectivity, wireless technology, and satellite communication can bring financial services closer to rural markets in desperate need of credit and banking opportunities. Likewise, improved access to market information for small and rural producers can dramatically increase their competitiveness which, in turn, makes providing credit and financial services more attractive to financial institutions. Also, increased access to financial and business planning services is critical to expanding the competitiveness of small and rural enterprises.

- **Tax and Fiscal Reform**: Tax reform is a very understudied and important issue in the region. Failure to collect taxes and consequent lack of revenues obviously is a major constraint for governments' ability to carry out their programs. The taxes that currently have high collection rates are the VAT taxes, which are regressive. Much more attention is needed to the structure and feasibility of collecting income taxes from both companies and individuals. More efficient tax administration would provide additional resources for governments to pursue anti-poverty programs, among other priorities.

  Subsidies to private companies are a related topic that needs better assessment. Governments may be offering subsidies and tax holidays too readily, in order to encourage companies to invest in their countries. Puerto Rico followed this "island model." The tax breaks deprive a host country of needed revenues, however. A tighter assessment of the net, long-term benefits of such subsidies for private sector-led development would be important for many countries in the region. Also, to the extent that anti-poverty subsidy programs in areas such as food, fuel, and education are necessary, governments in the region need to improve the targeting of those programs to ensure that they reach the intended beneficiaries.

- **Frameworks for Innovation**: Yet another area that will be critical to the long-term standing of the region's economies is its ability to support business and technological innovation. The need for innovation stems from multiple causes. In general, as one expert has said, "Our generation's challenge is to build an economy not based on cheap labor and primary natural resources."[25] And on a more near-term note, as one analyst has pointed out:

  > "Successful Latin American countries will have to learn to live with appreciated currencies. With interest rates in the developed world likely to stay floor-low for a while, money will continue to flow into the region's more promising economies. This will make them less competitive. There is not much they can do about it—accumulate reserves, impose capital controls and taxes, keep banks from credit sprees, increase productive efficiency. But those are either unsustainable measures or long-term reforms. The reality is that living in, or exporting from, places like Bogotá, Lima, São Paulo, or Santiago will be more expensive in U.S. dollars. It will be more difficult to sell our products in the United States and in any other country that keeps its currency tied to the U.S. dollar (notably, China). That is why success in trade will now depend more on new products. Although getting additional free trade agreements will still be good, creating new brands will be even better."[26]

The "greening" of the global economy offers one window for achieving the goal of a new, more value-added type of insertion by Latin American countries into the global economy. As nations grapple with the need to address and mitigate climate change, new low carbon products and technologies are urgently needed and being sought. In order to avoid its historic role as principally a source of raw materials, the region needs to find a way to insert itself creatively into these new markets. Bolivia's great potential to export lithium, a key input to long-lasting batteries, is often pointed to as one such new form of insertion in the emerging "green" global economy. Even in this case, however, Bolivia would continue to serve as a provider of raw materials.

One recent study of Bolivia's prospects for participating in the new global economy, beyond lithium sales, points the way to some new ideas.[27] George Gray Molina's recent assessment of new, high value products from Bolivia takes note of several potential germs of a "new economy" for Bolivia:

> "There is an alternative economy beyond the frontier of primary natural resources, *the other frontier*, based on environmental services, ecotourism, forest development, natural products trade (biocommerce), and organic agriculture, which generate employment preserving the environment and improving labour conditions. Thousands of producers, communities and associations have already built this other agricultural frontier in the most varied places: coffee, Brazil nuts, and organic cacao in the northern part of La Paz and

[25] George Gray Molina, "Human Development Report: The other frontier: Alternative uses of natural resources in Bolivia." United Nations Development Program, 2009
[26] Marcelo M. Guigale, "A Brave New World for Latin America." World Bank, Economic Premise, April 2010, no 10.
[27] George Gray Molina, op cit.

KEY TREND #5

Sustainable and appropriate ***technological and management innovation is a lynchpin for reviving the region's lagging competitiveness***. Innovation does not have to be high tech or capital intensive but does need to promote investments and innovations that not only contribute to sustainable economic growth, especially in rural communities, but also help them to participate in the global market in a manner that is not entirely dependent on extractive industries. Diversifying production from primary products continues to be a priority form of diversification.

> Pando; quinoa and vicuña wool producers associations in the High Plateau (Altiplano); lizard leather producers in Beni; indigenous communities that prevent the deforestation of the Noel Kempff Mercado Park, promote ecotourism in the Madidi National Park, and lead sustainable forest management in the northern Amazon and southeast forests."[28]

While only a few of these products and services — sustainable wood products and quinoa, for example — have achieved high levels of market insertion, they all reach out to take advantage of new markets in wealthy nations in a way that provides better quality jobs and greater environmental sustainability than historic jobs in Bolivia's mining or agricultural sectors. It may be useful to carry out a similar type of assessment for other countries in the region, as one small step towards supporting innovation in the regional economies.

In general, USAID should consider supporting capacities, programs, and policies that support business and technology innovation. This would not require a highly specialized knowledge of specific promising technologies. Instead, it would largely entail a new focus on economic policy frameworks. Successful innovation strategies show some common features: they are priorities of the state (they do not change from government to government); they are not based solely on markets; all relevant stakeholders are engaged (big and small, public and private); somebody is accountable for results; they are part of a broader effort of integration; they are well funded; they are continuously evaluated and adjusted; they begin with quick wins (usually in the area of quality standards); they include reforms in tertiary education; and they operate within a reliable legal framework.[29]

[28] Ibid.
[29] Marcelo Giugale, *op cit*.

Section Five

Overall Criticality of Governance Issues

The nations of Latin America have great talent, good natural resources and adequate capital inflows. The region principally lacks good governance, including functioning judiciaries, and institutions free from corruption and political manipulation, as noted in previous sections. Without reforms that increase the capacity of institutions to function effectively, competitiveness will be weak and the ability to do business will suffer. For example, it takes about fifteen minutes to set up a corporation in the U.S. In Brazil, the same process can and often does take over 200 days — and in Argentina, it is virtually impossible to achieve with full legality. Lack of transparency and accountability, along with a lack of an orientation to supporting businesses is hobbling economic growth in the region. Likewise, weakened justice systems and elevated levels of corruption and crime have cast a shadow on the legitimacy of government institutions which further undermine competitiveness and investor confidence that their investments will be respected.

Overall, there is a critical need in the region to improve the quality of development and the effectiveness (quality) of government expenditures. The general quality of economic systems — that is, how they are managed — in the region is a key to development that does not rely so heavily on external factors. While recent macroeconomic and monetary policy management in the region gives some reason to believe that things are improving, very much more remains to be done.

5.1 CONCLUSIONS

At the start of the 21st century, Latin America stands before a landscape of historic challenges mixed with great opportunities. Climate change, corruption and governance issues — too often centered in burgeoning urban areas — pose serious challenges that will shape the region's development path in the coming decade. The continuing low welfare status of indigenous and minority groups drags down the potential performance of every country where these groups have a large presence. At the same time, overall GDP stands to improve markedly once these groups are more fully integrated into the economy and society of their nations. A need to revive lagging competitiveness in the world economy calls for unprecedented innovation across the economies of the region, yet the emergence of a new "green" and low carbon global economy offers a strong opportunity for successful innovation. And, many countries of the LAC region move through an historic maturation of their populations, they face a unique chance to increase investments in individual health, education and productivity, raising the living standard and development prospects of the entire country.

USAID, with its long-standing presence and strong reputation in the region, can build on the existing base of its programs in the region to help strategically guide resources into areas that address the region's key challenges, while taking advantage of the opportunities it faces. This paper points to lines of program activities that, according to expert opinion, would make a real difference for the region in the context it faces. USAID should take the analysis and ideas presented in this paper to the next level, by identifying exactly where its bounded, strategic focus will be in the region for the coming decade. By setting five to seven ambitious and strategic goals for the region and aligning all resources to achieve them, USAID can and will make a tangible difference for development in the region in the coming years.

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AN ANALYSIS OF TRENDS:
Latin America and the Caribbean Economic Growth and the Environment, 2010–2020

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