

TC Document

1. Basic Information for TC

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| ▪ Country/Region: | REGIONAL |
| ▪ TC Name: | The Political Economy of Reform. How to Make Reforms Happen |
| ▪ TC Number: | RG-T4022 |
| ▪ Team Leader/Members: | Scartascini, Carlos (RES/RES) Team Leader; Acevedo Calle, Daniela (LEG/SGO); Ardanaz, Martin Jorge (IFD/FMM); Escobar Genes, Myriam Helvecia (RES/RES); Guevara Reyes, Sabina Margarita Angelica (CSC/CCH); Keefer, Philip Edward (IFD/IFD); Lally, Norma Alicia (CSC/CSC); Mancilla, Elton Alexander (RES/RES); Queijo Von Heideken, Virginia Lorena (CSC/CSC); Rodrigues Bastos, Fabiano (CSC/CSC); Sarrazin, Tom (RES/RES); Schineller, Sarah (IFD/IFD); Smith, John D. (RES/RES); Urquiola Ralero, Montserrat (RES/RES), Carlos (RES/RES) Team Leader; Acevedo Calle, Daniela (LEG/SGO); Ardanaz, Martin Jorge (IFD/FMM); Escobar Genes, Myriam Helvecia (RES/RES); Guevara Reyes, Sabina Margarita Angelica (CSC/CCH); Keefer, Philip Edward (IFD/IFD); Lally, Norma Alicia (CSC/CSC); Mancilla, Elton Alexander (RES/RES); Queijo Von Heideken, Virginia Lorena (CSC/CSC); Rodrigues Bastos, Fabiano (CSC/CSC); Sarrazin, Tom (RES/RES); Schineller, Sarah (IFD/IFD); Smith, John D. (RES/RES); Urquiola Ralero, Montserrat (RES/RES); |
| ▪ Taxonomy: | Research and Dissemination |
| ▪ Operation Supported by the TC: | N/A |
| ▪ Date of TC Abstract authorization: | . |
| ▪ Beneficiary: | All Borrowing Member Countries of the Bank |
| ▪ Executing Agency and contact name: | Inter-American Development Bank Carlos Scartascini, RES/RES, team leader and supervisor |
| ▪ Donors providing funding: | OC Strategic Development Program for Countries(CTY) |
| ▪ IDB Funding Requested: | US\$450,000.00 |
| ▪ Local counterpart funding, if any: | US\$0 |
| ▪ Disbursement period (which includes Execution period): | 18 months (12-month execution) |
| ▪ Required start date: | December 15, 2021 |
| ▪ Types of consultants: | Simple Source Selection for firms and individual consultants (PEC) |
| ▪ Prepared by Unit: | RES-Research & Chief Economist |
| ▪ Unit of Disbursement Responsibility: | RES/RES-Research & Chief Economist |
| ▪ TC included in Country Strategy (y/n): | NO |
| ▪ TC included in CPD (y/n): | NO |
| ▪ Alignment to the Update to the Institutional Strategy 2010-2020: | Institutional capacity and rule of law; Gender equality; Diversity |

2. Objectives and Justification of the TC

2.1 Latin America and the Caribbean (LAC) continue to be one of the slowest growing regions in the world. Between 1960 and 2019, the average per capita growth rate of real GDP in LAC was consistently below the world average. As such, while other regions have substantially narrowed the income gap with the United States, LAC has not. Boosting

inclusive and sustainable income growth is essential for raising living standards, even more so in view of the pandemic that has devastated the region. The IDB is committed to inclusive and sustainable growth as explicitly stated in its Vision 2025. Slow growth can be traced to distortionary public policies that both impede the accumulation of factors of production (capital and labor) and reduce incentives to use those inputs more efficiently (to increase total factor productivity). Historically, the region has suffered from low inputs accumulation, but most acutely from low productivity (Pagés, 2010). The policy reform agenda has long been well-understood – ranging from encouraging public investment and increasing fiscal stability to regulatory and institutional reform. Less well-understood is how to shift the political equilibria of countries to encourage citizens and politicians to embrace reform. This proposal will yield new approaches to the communication and design of policy reform, consolidating recent advances in the political economy of reform and collecting new evidence on novel communication and design interventions.

2.2 Reforms can only happen if policymakers are willing to enact them and citizens support them. Unfortunately, reforms are rarer in the region than ever. Polarization in the political system, low political party institutionalization, parties that are not programmatic, and fragmented actors make it very difficult to engage in transactions that would allow deals to make it to the decision table (Stein et al, 2011). Citizens distrust policymakers, therefore, they do not demand change that involves short term costs for long term benefits (Keefer et al 2018). Distrust feeds higher regulations, higher subsidies and more targeted transfers (Keefer and Scartascini, 2021). Broad-based reforms are not on the agenda and when governments try to advance them, they are rapidly defeated on the street. Moreover, even incremental progress is hard to detect.

2.3 The objective of this TC is to understand what should be reformed in LAC and how, what gets reformed and under what conditions, and how to increase trust in the citizenry. This TC is aligned with the Bank's Update to the Institutional Strategy 2010-2020, in specific with Institutional capacity and rule of law. This TC will attempt to help create a more distributive fiscal policy, strengthen the capacity of the state, and increase trust, which should help to provide inclusive infrastructure and infrastructure services. The products developed in this TC should help to achieve the objectives. Each one of the deliverables will have an associated knowledge product (as it is detailed below). These knowledge products will benefit dialogue with government authorities and help coordinate programming activities and country strategies. During the implementation of the TC, particular emphasis will be put into identifying the differential impact of the reforms across gender.

3.Description of activities/components and budget

3.1The project will have three main components. One of the components deals with the diagnostic of reforms and tools for achieving the objectives, the second, with the willingness of policymakers to propose and execute reforms, and the third with the willingness of citizens to support and accept the reforms. Each one of them has a series of subcomponents.

3.2 Component I. What should be reformed and how? This component will produce a diagnostic of where we are in the region and the reforms that took take place considering the broad heterogeneity of countries. It will also look into the tools and instruments that would be necessary to lead the region into the path of sustainable growth. Main deliverables: (i) policy brief that summarizes the findings. This policy brief will be disseminated using the IDB institutional channels: website, social media, etc., and through webinars/event to discuss the findings.

3.3 Component II. What is reformed, when, and how? This component will look at the existing literature on the political economy of reform in theory and practice and determine under what conditions reforms are more likely to occur. The deliverables of this component (as detailed below) will be disseminated using the IDB institutional channels: website, social media, etc, and through webinars/event to discuss the findings.

3.4 Subcomponent II.1. The political economy of reform. The discourse among policy makers about the political economy of reform reflects the state of the literature in the 1990s and 2000s. This subcomponent will identify the lessons learned from the last 10 years of academic literature that yields surprising lessons about the electoral consequences of reform, particularly fiscal reforms, and that identifies new obstacles to reform that goes beyond “concentrated winners” and “dispersed losers”. When do policymakers attempt reforms? What instruments do they use? What characterizes successful reforms? What have we learned about why people fail to support policies that are in their own interests? What have we learned about why people/politicians support inefficient policies (quotas) vs. efficient policies (tariffs)? How do the insights from more recent literature change the conclusions of past research on winners and losers, compensation, etc.? Main deliverables: (i) survey paper; (ii) policy brief that digests the main lessons for policymakers.

3.5 Subcomponent II.2. The economics of subsidies and transfers. Subsidies and targeted transfers are tools politicians love. They are easy to pass and they generate strong constituency support. However, they tend to generate inefficient allocations and are very difficult to roll back. This subcomponent will identify lessons learned from programs that incorporate subsidies and transfers, how does targeting occurs, and the costs of removing them. This work will be informed, again, by recent literature that examines politicians' incentives to adopt inefficient policies when more efficient policies would achieve their goals at lower or no social cost. It will complement work being carried out by INE looking at subsidies in the energy sector. Main deliverables: (i) survey paper; (ii) policy brief that digests the main lessons for policymakers.

3.6 Subcomponent II.3. What do we know about reforms? Taking stock of available data. Is the LAC region a reform laggard? Since international comparisons can spur policy makers to action, answering this question systematically will provide support to country dialogue. This subcomponent will therefore compile and analyze existing databases on reforms. The IDB has been a pioneer in this area by developing the Index of Structural Reforms, the Database of Budget Institutions, the Database of Tax Reforms, and several

others. Other institutions have developed new information on reforms. For example, the IMF has compiled an index of reforms that covers 90 countries until 2014. Main deliverables: (i) survey of available reform and institutions data and the implications they yield about LAC reform efforts; (ii) brief identifying areas of potential investment for data generation.

3.7 Component III. Reforms in an era of discontent. How to increase trust and engagement of the citizenry. Citizens preferences for reforms are affected by objective economic conditions but they are also affected by their ingrained beliefs and the information they receive, how much they trust the government authorities and other people, and the details of the implementation of the reforms. The deliverables of this component (as detailed below) will be disseminated using the IDB institutional channels: website, social media, etc, and through webinars/event to discuss the findings.

3.8 Subcomponent III.1. Information and beliefs. How do people process information in the age of social media? This subcomponent will look at the information generation process that takes place when reforms are announced and implemented. Social media has become the main source of information. This is the place where people gather information, react, and interact with others. Many reforms are born and die according to the reaction they get in social media. This subcomponent will use historical traffic data in Twitter and Facebook to identify how people react to reform news. It will take a few reform attempts that took place in the last few years and track who responds, how, and how the information disseminates within networks. It will also take the lessons learnt to devise an experimental setting to test how to best communicate reforms, when, and using which informational nodes within social media networks. It will combine survey and social media data to understand how people interpret reforms, to identify which messages change hearts and minds about reform options, and under which conditions, and how they disseminate and engage with that information. We are going to try to identify the drivers of news sharing and positive coverage and reactions. Main deliverables: (i) paper that exploits historical data; (ii) policy brief that digests the main lessons about how information is disseminated; (iii) experimental design paper.

3.9 Subcomponent III.2. Trust and reforms. The missing ingredient in LAC. LAC is facing a trust crisis. If citizens do not believe the government, they are not going to accept incurring costs today for benefits that may never materialize. Low trust in the government tends to be determined by power and information asymmetries. The government has information people do not have and the government can force people to do things they do not want. As such, the government can be opportunistic. One way that the government responded to the trust crisis is by increasing participation of citizens in decision making. That way, it can reduce both sources of asymmetries. Current methods of participation have two drawbacks. First, they do not necessarily reduce these asymmetries, since they are focused on increasing government information about citizen preferences not citizen information about government performance; and they do not facilitate the sustained and organized oversight of participating citizens of government. Second, they tend to increase resistance to reforms, since those who have the most to lose are the most likely to incur

the costs of participation. This subcomponent will test the role of information, power, organization, and new methods of participation that would help to increase trust and reduce resistance to reforms. Main deliverables: (i) Experimental design paper.

3.10 Subcomponent III.3. Winners and losers of reforms. This subcomponent will attempt to identify winners and losers of reforms, and how to design offsetting policies. The subcomponent would use one or two key structural reforms in Southern Cone countries and propose specific interventions to enhance social cohesion around the chosen reforms while accompanying its overall implementation. Main deliverables: (i) review paper that looks at social cohesion, and the role of digital technologies; (ii) experimental design paper. The cases will be selected according to the relevance of the reform and the conditions for implementation of the intervention. Non-objection letters will be requested when needed.

3.11 Subcomponent III.4. How to make reforms sticks? This subcomponent will explore how the specific components of a reform could affect its implementation and effect. In particular, there are open discussions about the size, timing, and distributional cost of the reforms. For example, is it better to remove subsidies or increase taxes once (even if the adjustment is large) or to propose a gradual removal or increases that take place over a longer period of time but of smaller magnitude? Should the reform also correct distributional inequities or be neutral? This subcomponent will use surveys and laboratory experiments to answer these questions. Main deliverables: (i) experimental design paper.

3.12 The total amount of funding needed is USD 450,000 (Funding: OC Strategic Development Program for Countries (CTY)) which will be allocated in the following way:

Indicative Budget

| Activity/Component | Description | IDB/Fund Funding | Total Funding |
|--------------------|--------------------------|-------------------|-------------------|
| Component 1 | Data Analysis researcher | \$ 70,000 | \$ 70,000 |
| Component 1 | Knowledge dissemination | \$ 10,000 | \$ 10,000 |
| Component 2 | Data Analysis researcher | \$ 100,000 | \$ 100,000 |
| Component 2 | Knowledge dissemination | \$ 20,000 | \$ 20,000 |
| Component 3 | Survey data collection | \$ 100,000 | \$ 100,000 |
| Component 3 | Data Analysis researcher | \$ 140,000 | \$ 140,000 |
| Component 3 | Knowledge dissemination | \$ 10,000 | \$ 10,000 |
| Total | | \$ 450,000 | \$ 450,000 |

3.13 Carlos Scartascini (RES/RES) will be responsible for the execution, supervision and monitor deliverables and payments. RES/RES will work in close collaboration with the region, CSC and IFD.

4. Executing agency and execution structure

4.1 This TC will be executed by the Bank through RES/RES.

4.2 Since all research activities will be coordinated by RES/RES, it is sensible that the administration of the resources is centralized by the Bank. This TC will be executed by the IDB because of its regional and multicomponent nature. The IDB is the most suitable organization to execute a project that will produce research that potentially covers all the countries in the region, and it requires identifying experts from all over the world and conducting multi-disciplinary approaches for delivering the expected outcomes: surveys, lab experiments, literature reviews, etc.

4.3 The activities to be carried out under this TC have been included in the Procurement Plan (Annex III) and will be executed in accordance with the Bank's procurement policies and procedures, namely: (a) Hiring of individual consultants, as established in the regulations AM-650; (b) Contracting of consulting firms according to GN-2765-4 and its associated operating guides (OP-1155-4) and (c) Contracting of logistics services and other services other than consulting, according to the GN-2303-28.

4.4 The activities of Component I and II will be developed by individual consultants, according to the Procurement Plan. Activities related to Dissemination and events are considered in all of the components, identified as non consulting services (GN-2303-28), and it may include small purchases that include travel, logistics, catering, editing, printing and translation. The activities of Component III that involve the collection of data for the Survey will be hired by Single Source Selection from Corporación Latinobarómetro.

4.5 Justification for Single Source Selection. The data required by the research project can only be accessed through Corporación Latinobarómetro, who investigates the development of democracy, the economy, and society as a whole, using public opinion indicators that measure attitudes, values, and behaviors. The results are used by the socio-political actors of the region, international and governmental actors and the media. Corporación Latinobarómetro is a non-profit NGO based in Santiago de Chile, solely responsible for the production and publication of the data. Latinobarómetro is a public opinion study that annually applies around 20,000 interviews in 18 Latin American countries representing more than 600 million inhabitants. This survey is used annually by the IDB in numerous publications. In particular, Latinobarómetro is one of the fundamental sources of information for the IDB's flagship book, Development in the Americas. This survey is the only one that collects data every year in the region. Therefore, it is the only provider of this service and even more so the only one that contains historical and comparative data that allows the IDB to make analysis with a historical perspective. To carry out this survey, the IDB has contributed annually together with other regional

partners. As of 2017, there is a formal agreement between Latinobarómetro and INTAL whereby the IDB provides financing and administrative support.

4.6 The TC does not contemplate reimbursement of expenses.

5. Major issues

5.1 There are no major risks for this TC. The TC has been developed to make sure that it can provide deliverables in the short run (12 months) but also set the stage for additional products in a 24-36 months window (second tranche of the TC). The TC will be readjusted if some of the products cannot be developed because of the pandemic or other unexpected negative shocks.

6. Environmental and Social Strategy

6.1 This TC is not intended to finance pre-feasibility or feasibility studies of specific investment projects or environmental and social studies associated with them; therefore, this TC does not have applicable requirements of the Bank's Environmental and Social Policy Framework (MPAS).

Required Annexes:

[Results Matrix - RG-T4022](#)

[Terms of Reference - RG-T4022](#)

[Procurement Plan - RG-T4022](#)