

TC DOCUMENT

I. Basic Information for TC

▪ Country/Region:	REGIONAL
▪ TC Name:	Inequality and Social Mobility in Latin America and the Caribbean
▪ TC Number:	RG-T3609
▪ Team Leader/Members:	Ibanez Londono, Ana Maria (VPS/VPS) Team Leader; Messina Granovsky, Julian Santiago (RES/RES) Alternate Team Leader; Gomez Davalos, Mabel (VPS/VPS); Molina, Silvana (VPS/VPS); Negret Garrido, Cesar Andres (LEG/SGO); Romero Pinto, Maria Jimena (VPS/VPS)
▪ Taxonomy:	Research and Dissemination
▪ Operation Supported by the TC:	N/A
▪ Date of TC Abstract authorization:	22 Jan 2020.
▪ Beneficiary:	IDB's Borrowing member countries
▪ Executing Agency and contact name:	Inter-American Development Bank
▪ Donors providing funding:	OC Strategic Development Program for Countries(CTY)
▪ IDB Funding Requested:	Total: US\$1,000,000.00
▪ Local counterpart funding, if any:	US\$0
▪ Disbursement period (which includes Execution period):	36 months
▪ Required start date:	April 15, 2020
▪ Types of consultants:	Individual consultants and consulting firms
▪ Prepared by Unit:	VPS-VP - Sectors & Knowledge
▪ Unit of Disbursement Responsibility:	VPS-VP - Sectors & Knowledge
▪ TC included in Country Strategy (y/n):	N/A
▪ TC included in CPD (y/n):	N/A
▪ Alignment to the Update to the Institutional Strategy 2010-2020:	Social inclusion and equality

II. Objectives and Justification

- 2.1. Latin America and the Caribbean (LAC) is one of the regions with the greatest and most persistent inequality levels in the world. In 2018, the top 10% in Latin America received 42.4%¹ of national income, while the poorest 10% poorest received 1.4%. The aggregated figures hide a large heterogeneity across countries in the region. In 2018, the country with the highest Gini coefficient was Brazil (0.539), and El Salvador (0.386) with the lowest.² Despite the recent sharp reductions in poverty levels across the region, inequality trends have declined at a much slower pace. Poverty rates declined from 43.5% in 2000 to 23.3% in 2018,³ while the Gini coefficient for income decreased from 0.561 to 0.517.
- 2.2. LAC continues to be the most unequal region in the world. Nine of the 20 most unequal countries in the world are in the region: Brazil, Colombia, Honduras, Panamá, Costa Rica, Guatemala, Paraguay, México and Nicaragua.⁴ In addition, intergenerational

¹ LAC Equity LAB, World Bank.

² LAC Equity LAB, World Bank.

³ LAC Equity LAB, World Bank.

⁴ World Bank most recent Gini estimates.

social mobility continues to be low. In OECD countries it would take 4.5 generations for a child born in a low-income family to achieve the average level of income. This figure is 6, 9 and 11 generations for Chile, Brazil and Colombia, respectively.⁵

- 2.3. The structural causes of inequality, the inability of governments for implementing redistributive policies that provide a level playing field, the pervasive informality on labor markets and small firms, an overall lack of competition culture, and low investments in education may partially explain the high inequality levels in the region and the factors that sustain it. All of these factors are also barriers to economic dynamism. They hinder the optimal allocation of resources, provide insufficient incentives for educational investments, and discourage dynamic entrepreneurship and risk-taking. The region might be trapped in a low growth-low productivity and high inequality equilibrium. Understanding the main causes driving inequality and low growth in the region is crucial to identify the public policies and regulations required to address it and avoid its harmful consequences.
- 2.4. The relationship between inequality and growth is complex and in theory ambiguous. In imperfect markets, inequality limits poorer individuals from making optimal investments in human capital, leading to sub-optimal allocation of resources (Galor and Zeira, 1993).⁶ Excessive income concentration may also hamper industrialization and the emergence of new economic sectors (Murphy, Shleifer and Vishny, 1989).⁷ Other have argued that low wealth is likely to reduce entrepreneurial effort due to moral hazard considerations (Aghion and Bolton, 1997).⁸ Positive arguments include the higher ability of richer individuals to save, the necessity of some level of inequality to provide individuals the necessary incentives to take risks and invest, and political economy considerations (Forbes, 2000).⁹
- 2.5. Considering these ambiguous theoretical predictions, and the difficulty of untapping causal relationships in cross-country data, it is perhaps not surprising that the empirical literature is inconclusive. Some studies have found negative effects of inequality on growth (Ferreira et al., 2018),¹⁰ while other have found the opposite (Li and Zou, 1998).¹¹ As Banerjee and Duflo (2003)¹² conclude “On the more fundamental question of whether inequality is bad for growth, our data has little to say. It is clear that the most compelling evidence on this point has to come from micro data”. While some forces behind inequality may be desirable –e.g., those related to individual effort–, others are likely to be harmful for growth –e.g., those linked to inequality of opportunities during childhood, insufficient competition due to protected interests, and cronyism. Latin America comes across as being tilted towards the latter set of forces. This TC will dwell on many of these potential channels.
- 2.6. Reducing inequality, promoting economic growth, increasing social mobility and leveling the playing field should thus be a priority in Latin America and the Caribbean. Nonetheless, addressing the causes of inequality is a complex process that requires

⁵ OECD Statistics.

⁶ Galor, O. and Zeira, J. (1993), *Income Distribution and Macroeconomics*.

⁷ Murphy, K., Shleifer, A. and Vishny, R. (1989) *Income Distribution, Market Size and Industrialization*.

⁸ Aghion, F., and Bolton, P. (1997) *A Theory of Trickle-Down Growth and Development*.

⁹ Forbes, K. (2000) *A Reassessment of the Relationship between Inequality and Growth*.

¹⁰ Ferreira, F., Lakner, C., Lugo, M. and Özler, B. (2018) *Inequality of Opportunity and Economic Growth: How Much Can Cross-Country Regressions Really Tell Us?*

¹¹ Li, H. and Zou, H. (1998) *Income Inequality is Not Harmful for Growth: Theory and Evidence*.

¹² Banerjee, A. and Duflo, E. (2003) *Inequality and Growth: What Can the Data Say?*

a democratic consensus and implies increasing transfers, through taxes, labor and anti-trust regulations among others, from wealthy to less privileged groups of the society. The IDB can play an important role to support countries throughout this process by generating knowledge on the causes, the extent of inequality and its consequences; promoting an informed debate among policy-makers and stakeholders in the region; providing technical support to design effective public policies and regulations to increase equality, economic growth and social mobility; strengthening technical capacity on this topic in the region; and mainstreaming inequality in its operations.

- 2.7. **Objectives.** The purpose of this three-year project is to generate knowledge and strengthen technical capacity in the region to support IDB's role on reducing inequality and promoting economic growth. The project will follow a three-pronged strategy. First, the project will compile existing data on inequality and social mobility. Second, the project will produce a series of studies to understand the relation between economic growth and inequality, the main drivers of inequality in LAC and the most effective policies to reduce inequality and promote social mobility. The studies will mostly concentrate on the sector priorities and scope of intervention of the IDB. Third, the project will promote an informed debate since the start of the project within the IDB and the region to discuss the causes of inequality, the relation between economic growth and inequality, potential solutions and the way forward. Given the recent wave of social unrest in some countries of the region and the need of governments, this technical cooperation will provide inputs, knowledge and public policy alternatives to address the rising demands of LAC governments to the IDB on this issue.
- 2.8. **Strategic Alignment.** This TC is consistent with the "Update to the Institutional Strategy. Development Solutions that Reignite Growth and Improve Lives" (AB-3190-2) and is aligned with the development challenge of Social Inclusion and Equality, by providing knowledge and public policy alternatives to promote the reduction of inequality and more social mobility in the region. The TC is also framed within the operational guiding principles of the Update to the Institutional Strategy responsiveness, multisectoral, leverage and partnerships, as well as innovation and knowledge, as it will provide inputs for better solutions, and apply lessons learned from our work and from others. Additionally, the TC is consistent with the "Sector Strategy on Institutions for Growth and Social Welfare" (GN-2587-2) and the "Strategy on Social Policy for Equity and Productivity" (GN-2588-4). Lastly, the TC aligns with the "Ordinary Capital Strategic Development Program for Countries" (GN-2819-1) by studying social exclusion and inequality in the countries of the region and identifying policies that help address both issues.

III. Description of activities/components and budget

- 3.1. This technical cooperation will have two components and will count on a Task Force (TF) composed by the Sector Economic Advisors (SEA), Regional Economic Advisors (REA), and a person representing the Department of Research and Chief Economist (RES). The TF will provide inputs for selecting the topics and the consultants of the studies in the first component and oversee the work of the consultants. The TF will ensure that the priorities identified in the Sector Framework Documents, knowledge agendas and operational agendas are included in the TC. Two consultants will advise and support the TF.
- 3.2. **Component 1: Analysis on the causes of inequality and the policies to reduce inequality and promote social mobility.** The first component will fund 14 studies to

explore public policies aimed at reducing inequality and improving social mobility. In addition, the component will strengthen capacity in the region on this topic by promoting the creation of a network of academic, policymakers, stakeholders and practitioners. The projects will fund papers on: (i) the relation between inequality and growth; (ii) policies to address the structural causes of inequality that are related to the IDB priorities and operations; (iii) fiscal redistributive policies; and (iv) other consequences of inequality.

- 3.3. The Task Force, with support from the two consultants, will define the specific topics each study will address and the consultants that will work on each paper. Also, the Task Force will draft the terms of reference for each working paper, provide comments, and oversee the quality of the papers. Lastly, the TF will ensure that the countries selected for the case studies represent the different dynamics within the LAC region. For this, the Task Force will design the selection criteria, which will include at least the following for topics and countries: (i) the gaps existing on the literature; (ii) the causes that can be more effectively addressed through State intervention (public policies, regulation and fiscal policy); and (iii) the alignment with the priorities of the IDB. The selection of the countries will ensure an equal balance across the four regions of the IDB and will include at least one country of each of the regions. In order to identify what is known in the literature for selecting the topics and the countries, VPS/VPS commissioned a short consultancy project to perform a literature review on the existing knowledge for this topic in Latin America and the Caribbean. This will serve, along with the Inequality Report in which RES is working currently, to select the topics of the TC.
- 3.4. Some public policies that directly address the structural causes of inequality that might be included in the project are investment in human capital, the promotion of equal access to opportunities, improvements in productivity, the reduction of informality of labor markets and small firms, interventions on local labor markets and promotion of a level playing field conducive to firms' investment, innovation and a robust market competition, among others. Knowledge on social mobility, its relationship with income redistribution, and its role on the current social unrest in LAC will also be explored as well as the effects of inequality on social cohesion, trust, the weakening of the social contract, the reduction on state legitimacy and the concentration of political power. The studies will provide policy recommendations that may contribute to strengthen the design of the IDB's operations. Intellectual property rights of any product resulted from these studies will be property of the Bank.
- 3.5. **Component 2: Promoting the debate on inequality: Causes of inequality, solutions and the way forward.** The ultimate goal of the project is to promote an on-going informed debate such that the governments and the society identify and push for policy changes to improve equality and social mobility in the region.
- 3.6. As results from Component 1, dissemination activities based on this information will be designed. The dissemination activities, throughout the duration of the project, will include: (i) one seminar to launch the project, two intermediate seminars to discuss the on-going work of the project, and a final seminar to present the results of the project; and (ii) the production of dissemination material for the wider public, including a public website (hosted in the Bank's Website) with information on the results of the studies on inequality. The results will be shared with Bank specialists to enrich their dialogue with policy makers in the region.
- 3.7. The total cost of this TC will be US\$1,000,000, which will be funded by the Ordinary Capital Strategic Development Program for Countries (CTY) of the Bank.

Indicative Budget (US\$)

Component	Description	IDB Fund (CTY)	Total
Component 1. Analysis on the causes of inequality and the policies to reduce inequality and promote social mobility	Advisors	90,000	90,000
	Studies	490,000	490,000
	Research fellow	210,000	210,000
	Total Component 1	790,000	790,000
Component 2. Promoting the debate on inequality: Causes of inequality, solutions and the way forward	Website, dissemination strategy and dissemination products	110,000	110,000
	Workshops	100,000	100,000
	Total Component 2	210,000	210,000
Total		1,000,000	1,000,000

IV. Executing agency and execution structure

- 4.1. The execution of this TC will be carried out by the Bank through the Vice Presidency for Sectors and Knowledge (VPS/VPS). The role of the Bank as executor is justified in that this TC represents an initiative promoted by the Bank, and the products and activities envisaged will generate knowledge and strengthen technical capacity of the Bank and its member countries.
- 4.2. VPS/VPS, through the TC's Team Leader, will lead the project with the support of a Task Force (TF) which will provide inputs to select the topics and countries of the studies in the first component, propose the consultants for undertaking the studies, draft the terms of reference, and oversee the work of the consultants. The SEAs and REAs will consult within their sectors and regional offices to collect ideas and proposals to incorporate in the project. Two consultants will join the project team. Their role is to advise and support the TF, write a compilation paper on the results of the project, and coordinate the publication of the results of the project on a highly renowned university press.
- 4.3. In the cases where an activity requires to be carried out in any identified beneficiary country, such as academic seminars, the Team Leader will obtain a non-objection letter from the Bank liaison entity in such country prior to the commencement of the activities.
- 4.4. The activities to be executed under this project have been included in the Procurement Plan and will be executed in accordance with the Bank's established procurement methods, namely: (a) Recruitment of individual consultants, as established in Regulation Complementary Workforce (AM-650) standards; (b) Hiring consulting firms for services of an intellectual nature according to the Policy for the Selection and Contracting of Consulting Firms for Bank-executed Operational Work (GN-2765-4) and its associated operational guides (OP-1155-4); and (c) Hiring of logistic services and other services other than consulting, according to the IDB Corporate Procurement Policy (GN-2303-28).
- 4.5. The Team Leader will be in charge of the monitoring and supervision of the TC. The monitoring activities will be carried out during the period of execution of the TC in compliance with the Technical Cooperation Monitoring and Reporting System (OP-1385-4).

V. Major Issues

- 5.1. The cancellation of presential dissemination events due to unforeseen circumstances is also a potential risk. If this is the case, the project team will translate them into online or digital formats, such as web seminars, online meetings, among others. Lastly, some of the proposed studies might not be able to access the required data to undertake the study. To mitigate this risk, the TF will select the topics and country studies taking into account data availability.

VI. Exceptions to Bank policy

- 6.1. There are no exceptions to Bank policy foreseen under this TC.

VII. Environmental and Social Strategy

- 7.1. There are no environmental, social risks or impacts associated with this program. According to the Environment and Safeguards Compliance Policy (OP-703) this TC have been classified as "Category C" (see [Safeguard Screening Form](#) and [Safeguard Policy Filter Report](#)).

Required Annexes:

[Results Matrix_36883.pdf](#)

[Terms of Reference_6940.pdf](#)

[Procurement Plan_44167.pdf](#)