

The Importance of Knowledge in Uncertain Times

Remarks at Knowledge Week Closing Panel, Inter-American Development Bank (IDB), Washington, DC, October 27, 2023

Mauricio Cárdenas

Q: Many policy decisions are taken with a high degree of uncertainty. Could you tell us an example of how the existence of knowledge made your decisions easier or at least eased the sense of risk-taking when confronting decisions with uncertain outcomes?

A: Let me first thank President Ilan Goldfajn and Sectors Vice-president Ana María Ibáñez for inviting me to participate in this closing session. The Knowledge Week has been a great step in building the necessary symbiosis between knowledge and operations, which should be a distinctive trait of any development bank. In the specific case of the IDB, generating and disseminating knowledge is the number one tool to maximize development impact. Loans are helpful, but they are clearly not sufficient. Without research informing and interplaying with policies, financing alone cannot materially change development trajectories.

A second point is that today's challenges are more regional and global than several decades ago when the charter of these institutions was conceived. Issues like South-South cooperation are more relevant now relative to a phase when the priorities had a strictly national dimension. Infrastructure interconnectedness, regional efforts to protect forests, intra-regional trade to reduce risks of geo-economic fragmentation, are some examples of why regional initiatives have gained relevance.

A third element is that the level of uncertainty has increased. There are various ways to measure this, but the polycrisis and the resulting volatility in individual incomes illustrate the point. Knowledge should help us navigate policy action in uncertain times.

Now let me turn to your specific question.

I will begin with a concrete example of how the existence of knowledge made decisions easier for me, or at least eased the sense of risk-taking in a context of uncertain outcomes. The example I will provide comes from my experience as Colombia's finance minister. Less than a month after I was sworn-in, I submitted a bill to Congress proposing a significant reduction in payroll taxes. This was an informed but nonetheless risky decision, mostly because the revenues for early childhood programs –and other important social programs- depended on these taxes. It was the perfect example of a bad tax with a good purpose.

The decision was informed in good part as a result of the IDB's research agenda on labor markets. Early in my career, together with Adriana Kugler and Raquel Bernal, we conducted research as part of an initiative led by Carmen Pages and Ricardo Hausmann at the IDB, with the external support of Jim Heckman and Dan Hamermesh. After those initial papers, and many others that followed from a number of colleagues, the evidence on how payroll taxes had increased

labor informality became overwhelming. Due to that body of knowledge (and I would underscore the word body here because complex and risky decisions should not be based on one paper only) I had no hesitation to propose to Congress the reduction of payroll taxes, combined with the need to offset the revenue-loss effects with an increase in income taxes.

Uncertainty also played a role. Social programs with funding that depended on payroll taxes, and the institutions that hosted them, were opposed to the reform. To tackle this aspect, which became central along the debate of the bill, the proposal was amended establishing a budget guarantee for early childhood and labor training programs. This change—which facilitated the passage of the reform in Congress—suggests that dealing with uncertainty is crucial. In this case it was worth putting a floor on the budget of these programs because the intention of the reform was not to downscale them. Multiple academic studies have provided unambiguously favorable evaluations of this reform in terms of impact on labor markets. Early childhood and labor training programs also benefited from more secure (and increasing) funding.

On the topic of uncertainty, I'd like to make a second comment, as many policy decisions need to be taken without complete or at least sufficient information. In 1999, in the midst of a severe economic crisis, Colombia's unemployment rate was above 20%. To help mitigate the effects on poverty, the Department of National Planning (DNP), which I directed at the time, was tasked with creation of a social safety net. Together with the IDB and the World Bank we opted for calculated experimentation through three different programs: Conditional cash transfers for families with school age children in rural areas, support for the creation of technical and technological programs for the unemployed youth, and small labor-intensive public works programs in cities (*Familias en Acción*, *Jóvenes en Acción*, and *Empleo en Acción* were their names). We did not know ex-ante how effective these interventions were going to be. *Familias en Acción* turned out to be the most successful program in terms of impact, later expanding to urban households, and becoming the cornerstone of social interventions to this day. The other programs were subsequently phased out. Experimenting with three different programs was the right thing to do at that time due to the lack of information.

* * *

Q: What are the key areas that academia, multilateral, and think tanks should deliberately address that are critical for LAC?

A: If you had told me in 1999 that in the next two decades no LAC country would have a deep financial crisis --that the Global Financial Crisis and the Covid-19 pandemic would not result in a banking crisis-- that low inflation would prevail, that credit spreads would remain relatively low, I would have said that the chances of that happening were very small. So, on those grounds, outcomes have been extremely good.

But when we think about GDP growth, or productivity and wage growth, the outcomes have been disappointing (current forecasts being equally dismal). As Larry Summers said during the release of recent G30 report, this makes Latin America's story one of macroeconomic virtue not fully rewarded. Under these circumstances there is a great risk to return to misguided macro policies which can do infinite damage. Instead of abandoning macro stability, we need to ensure that it yields its full potential. Work in areas such as skill of workers, creativity and drive of entrepreneurs, low crime, and many other aspects related to the quality of the institutions, is indispensable.

Beyond the condemnation of populism, the synthesis that can generate prosperity is very country specific. To borrow Anna Karenina's principle of development from Tim Besley and Torsten Persson's *Pillars of Prosperity*: "All prosperous countries resemble each other; every non-prosperous country is non-prosperous in its own way."

In terms of the key knowledge areas for the future, there is a second principle (paraphrasing the Japanese influencer Marie Kondo): Governments need to get rid of what is not working. There is simply not enough space in the (fiscal) closet to accumulate programs with dubious effects. In today's high-debt, high-interest rates environment, no

government should add new programs before eliminating a few. This, of course, also speaks about generating and disseminating knowledge from impact evaluations studies. The IDB can play a very important role in this regard.

Finally, I am very skeptical of the ability of our region to meet its developmental challenges on the grounds of foreign aid. Unfortunately for us, we are not prominent in the policy agenda of the advanced economies. Part of that is that LAC has had no war, famine, financial catastrophe, so there is no surprise in LAC being left out in matters of aid. More so if, in a world of superpower competition, Latin America becomes more neutral and independent. Our future relies on what we can do for ourselves.

In this context, research needs to continue to look for answers, beginning with those areas where Latin America is an outlier relative to the rest of the world. The pertinent questions have not changed much: Why is inequality so entrenched? Why are crime rates so high? Why is (firm and employment) informality so pervasive? Why is productivity growth so slow, or even negative?

In addition to these perennial questions, there are the newer questions related to the fact that the region is heavily exposed to pandemics and climate change. We learned in a very traumatic way that we have very low levels of pandemic preparedness and climate adaptability. An important aspect of the research agenda is related to the interdependencies between these dimensions. For example, exploring the interactions between climate and inequality, climate and health, informality and health, to mention just a few, will be helpful in order to establish priorities for action.

* * *

Q: How can academia and multilaterals collaborate in knowledge creation, dissemination, and evaluation of its impact into policy making? Can you give us some insights on how to strengthen the dialogue between researchers and policymakers?

A: The complexity of the challenges demands sound and rigorous analyses which oftentimes are hard to communicate. However, there are ways to overcome this problem. Although the skillset for the generation of knowledge is different from the one required for dissemination, when knowledge is produced by local researchers there are greater opportunities for impact. Promoting knowledge in the region and for the region should be the goal. One important reason is that the generation of local knowledge creates many positive externalities, including the training of talent and the diffusion of ideas to key stakeholders. All this points in the direction of the IDB teaming with local research groups in universities or policy-oriented think tanks. The IDB's comparative advantage lies in its capacity to convene and connect local researchers with experts in the rest of the world, including from within the region.

On messaging, research centers are becoming better at reaching audiences outside academia. Using social media, writing for non-technical audiences, participating in congressional debates, are some ways in which ideas can have greater impact. My last point has to do with the ability of research sponsored by the IDB to be controversial, even uncomfortable. It is essential to ensure academic freedom, and to separate the bank's policies and views from those of its individual researchers or external groups sponsored by the bank. It is crucial that the governments of its member countries fully appreciate the importance of this point.