

Framing MCC's Work around Intergenerational Transmission of Poverty

Since its inception, MCC has focused its analytics and investment design on promoting growth as a means to sustainably reduce poverty. As MCC approaches its 20th year, the goal of poverty reduction remains front and center, but the challenge of poverty's persistence over time remains a challenge in many partner countries. The intergenerational transmission of poverty (IGTP), i.e., the economic immobility of children born to poor parents, presents challenging questions about MCC's model and approach. Understanding how MCC's analytics and investments fit within the larger landscape of poverty dynamics can help inform the scope of its growth diagnostics, its calculation of economic returns, and ultimately the prioritization of investments.

Intergenerational Transmission of Poverty in Developing Economies

While some drivers of poverty are episodic, e.g., conflict, disease, drought, or macro-level mismanagement, others operate persistently across successive age cohorts and generations within families, posing unique challenges to policy makers. IGTP speaks to the inability of new entrants in the workforce, particularly those below the poverty line, to achieve higher incomes and greater well-being than their predecessors from below the poverty line.¹ Upward mobility across income strata not only reflects more efficient and equitable allocations of people to productive opportunities but bears increasingly on worsening conditions of inequality worldwide.

High correlations between incomes of successive generations point to specific drivers of poverty that transmit within families. Chief among these is low levels of human capital, encompassing education, nutrition, and health. As described early on in Becker and Tomes (1979), parents impart traits and habits to children and optimally invest in their education and health to achieve some desired level of children's well-being. Other constraints also lead to sub-optimal investment in human capital, including on the *demand* side (e.g. inefficient capital markets, imperfect information, high out-of-pocket fees), on the *supply* side (e.g. crowded and low quality education, absenteeism, poor infrastructure), or externalities affecting private demand (e.g. role of children's labor supplementing household incomes, distance to school, etc.).

In developing economies, where rates of IGTP are higher than the rest of the world, constraints to human capital formation and ultimately economic mobility, are particularly binding. The share of the developing economy population that surpasses its parents' education levels (years of schooling completed) has stagnated for over half a century (World Bank, 2018).² From this pool, South Asia and sub-Saharan Africa exhibit the greatest correlation between children and parents' earnings and educational status. Among MCC partner countries, less than a quarter of the cohort born in the 1980s exceeds their parent's education level in Zambia, and just under 40 percent in Mozambique and Sierra Leone. The share improves to roughly two-thirds in Indonesia, but nevertheless a sizable share does not

¹ Other terminology appears throughout the literature, including intergenerational mobility, income mobility, and socioeconomic mobility. Intragenerational poverty transmission sometimes stands apart, referring to movement out of poverty in one's lifetime.

² While income mobility is the objective, education data often serves as a useful proxy. Apart from the challenges of observing incomes within households over multiple generations, education, once acquired, does not vary over an individual's lifecycle. In contrast, income can be vulnerable to exogenous temporary shocks.

surpass its parents (GDIM, 2020). Meanwhile, across these four countries, people born to parents in the bottom half of the educational distribution reached the top quartile only about 10 percent of the time (*Ibid*).

Himanshu and Lanjouw (in Iverson et al, 2021), in a recent survey of estimates of income mobility, find broad evidence of mobility in select countries but also incidence of chronic and persistent poverty in many others. Poverty dynamics in sub-Saharan Africa are particularly challenging. Distinguishing between “always poor” and “sometimes poor” (*i.e.*, slipping in and out of poverty), they find persistent poverty in half or more of the population for MCC partners Burkina Faso, Zambia, Mozambique, and Malawi and high levels of sustained vulnerability.

IGTP’s interaction with inequality also bears consideration. Corin (2013) and Kreuger (2015) show strong cross-country correlations between intergenerational earnings mobility and Gini coefficients, as manifested in the so-called “Great Gatsby Curve.” Similarly, low earnings mobility correlates with greater inequality of “opportunity” (Iverson et al, 2021). These outcomes raise the question of whether interventions that reduce income inequality and expand access of low-income households — e.g. means-tested transfers, enhanced public service delivery in lagging regions, progressive taxation, anti-discrimination policies, etc. — could offer a separate and complementary approach to MCC’s traditional investments to reducing persistent and chronic poverty.

Targeting Investments and Beneficiaries to Reduce IGTP

One entry point for breaking IGTP is to give children more “early life” opportunities, including schooling, nutrition, and immunizations (Attanasio et al., 2021; Narayan et al., 2018). Increased rates of early childhood education and stimulation can improve outcomes that persist later in life (Gertler et al., 2021), as well as investments in education-related infrastructure, *e.g.*, school construction (Aguero and Ramachandran, 2020; Akresh et al., 2018; Lambert et al., 2014). But long-run multi-generational benefits may not materialize unless investments in human capital are sustained over time, suggesting the effects of one-off investments might quickly dissipate (Behrman et al., 2017). Separately, investments in the human capital of *parents* may also confer benefits on children.³ Most directly, interventions in the health of expecting mothers plays a key role in determining human capital outcomes among future adults (Narayan et al., 2018; Bhalotra and Rawlings, 2013).

Based on this understanding, some of MCC’s investments potentially fit within a larger strategy for tackling IGTP. While relatively modest, MCC investments in the education sector in Guatemala, El Salvador, Georgia, Burkina Faso, Niger, Cote d’Ivoire, and Morocco have ranged from school construction to teacher training to funding TVET-style programs. MCC has funded programs in maternal and child health in Indonesia as well as water, sanitation and health (WASH) projects in Lesotho, Mozambique, Zambia, Sierra Leone, and Timor Leste.

The question remains, however, given its overarching mission of sustainable poverty reduction through growth, whether MCC’s efforts cover the appropriate range of development priorities. Targeting

³ A stark example is the impact of HIV/AIDS in young adults on the education of their children and risking a downward spiral or even economic collapse (Bell, Devarajan and Gersbach, 2003).

investments to children and youth can reap future rewards, but by the same token, raising the employment and incomes of today's parents—through funding infrastructure and policy reform—increases their ability to make private investments in their children's human capital.⁴ Further, and apart from any effects on human capital, projects that lead to a sustained increase in private investment, structural transformation, and growth may support expansion of opportunities for subsequent generations, reducing poverty over time although intergenerational poverty transmission could persist.⁵

Put simply, MCC has primarily focused on productive infrastructure investments, *i.e.*, roads, power, ports, and WASH. How much do these investments generate benefits to support income mobility of poor households and support future generations? At the margin, how would returns to additional investments in infrastructure access and uptake, so-called “last mile” interventions, compare to programs in human capital targeting children and youth? In general, should MCC's portfolio strike a new balance between infrastructure and policy reforms that foster better conditions for growth versus human capital investments to drive productivity itself?

MCC Investment Criteria and Transmission of Poverty

IGTP raises important questions about accounting for the time horizon of benefits, both in terms of investment design and cost-benefit analytics. Implicit in MCC's investment choices is the trade-off between serving present versus future generations. MCC's 5-year time window for grant delivery favors “one-and-done” projects that can be built quickly and realize benefits right away. Thus, benefits from building roads, generating power, or irrigating farmland must begin to accrue to households and firms in the near-term.⁶

Meanwhile, within MCC's cost-benefit analyses, the long-term benefits of investments diminish significantly under the weight of MCC's high 10% discount rate. Benefits to children that materialize after 20 years are trivialized in present-day values.⁷ Demand estimates based on willingness to pay (WTP) surveys often fail to capture value beyond current beneficiaries, either owing to externalities, respondents' own heavy discounting, or imperfect information. For example, an estimate of household WTP for electricity likely does not fully capture benefits to respondents' children. “Should MCC more intentionally account for future beneficiaries in its work?” applies not only to projects related to human capital, but all MCC projects with indirect linkages to children's long-run well-being.

Separately, MCC's initial growth diagnostics often lean towards presently urgent and binding constraints, usually in the form of critical infrastructure gaps and distortive policies, in contrast to the slow-burning priorities of an educated, healthy, and productive workforce. Prioritizing between these two broad categories may require flexibility for longer term investments and a better analysis of future beneficiaries. Mincer-style regressions, for example, reveal the income effects of marginal

⁴ Raising the incomes of parents can also be achieved through simple direct cash transfers. But MCC generally does not subsidize benefits in this form.

⁵ Though skill demands will grow as well, so human capital investments will also be required for sustained growth.

⁶ Notably, long term environmental impacts—arguably as important as human capital to the welfare of the next and subsequent generations—are similarly heavily discounted. Alternative approaches to discounting to allow for environmental and climate change impacts are currently being considered by MCC.

⁷ Standard practice is to conduct CBA over a 20-year horizon, although longer periods can be used. However, each dollar of return between 20 and 30 years later as the next generation comes of age, is only valued at around 9 cents in present value terms.

improvements to a worker's schooling based on past survey data, offering at best a signal on recent market returns to education and skills. Do other indicators better capture long-run human capital constraints and future needs?

On a broader level, what do rapidly evolving technologies, both in terms of ICT and labor-saving manufacturing processes or even climate change, portend for IGTP? Does the advent of more service-oriented but technologically sophisticated sectors potentially raise the impact of education on enhancing socioeconomic mobility, effectively raising the stakes of human capital investments? Do worsening climate conditions for agriculture increase the barriers to food productivity growth and threaten to entrench future generations in rural poverty? What implications do these conditions have if MCC were to embrace IGTP-related policies and priorities?

Questions for the EAC

- Should MCC broaden its current analytic and investment design scope to explicitly address persistent chronic poverty, inequality, and IGTP reduction? Would such broadening imply a departure from MCC's comparative advantage in infrastructure investments that pay off immediately?
- Are there investments in specific sectors *outside* education and health that substantially reduce IGTP? Are there unappreciated benefits to roads or power, for example that accrue to future generations and, in turn, merit a fuller accounting in MCC's cost-benefit analyses?
- In countries where shortcomings in basic schooling and human capital formation loom large, are there long-term human capital diagnostics that complement MCC's traditional constraints analysis?
- Should MCC revisit CBA practices to better capture later generations' well-being? Are there implications for targeting 'last mile' beneficiary access or for time discounting used in CBA?
- Given the work of other aid agencies targeting IGTP through health and education support, how should MCC consider its comparative advantage in deploying scarce grant capital?

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