

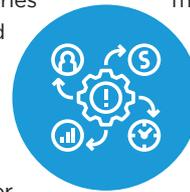
# What are the Main Development Gaps in Latin America and the Caribbean?

- Identifying country and sector development gaps can help the public and private sectors prioritize and target investments.
- The Development Gaps approach identifies the most glaring deficits in a country or region from “10,000 feet above”.
- A recent IDB Invest study built on the Development Gaps approach to include private sector indicators across 15 sectors and 58 dimensions.
- Across Latin America and the Caribbean, gaps are most prevalent in areas related to economic complexity, transport infrastructure, financial inclusion, and education quality.
- Multilateral development banks can use these results to inform decision-making and help mobilize resources towards priority development challenges and the SDGs.



## IDENTIFYING DEVELOPMENT GAPS

The UN Sustainable Development Goals (SDGs) provide a common framework for talking about global development challenges, encompassing a wide range of targets to be met by 2030. As countries have aligned with the SDGs and set targets accordingly, a deeper understanding of the main development gaps within specific sectors – and the private sector’s role in addressing them – is helpful for prioritizing investments from both governments and multilateral development banks (MDBs).



The Development Gaps approach attempts to determine the relative extent of development deficits in different economic and social areas of a country. It provides a first step towards uncovering the overall pattern of development challenges, that together with deeper sector analyses, help to illuminate investment priorities.



## DEVELOPMENT GAPS STUDY

The Development Gaps approach was originally conceived with a public sector focus to provide guidance on investment priorities for the 26 IDB borrowing member countries in Latin America and the Caribbean (LAC).<sup>1</sup> IDB Invest recently published a study proposing methodological innovations to this approach, incorporating an expanded set of private sector-focused indicators related to areas such as financial inclusion and firm-level development. The study computes development gap estimates for 161 indicators in 26 countries across 15 key sectors and 58 dimensions (which capture the relevant development areas for each sector).

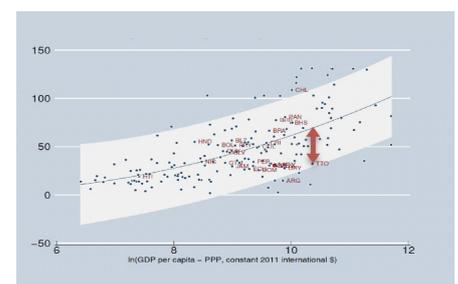
The sectors span physical and social infrastructure, corporate industries, financial development and inclusion, and cross-cutting issues such as climate change, gender, and institutions. The individual development gap estimates are first aggregated into relevant development dimensions within each sector, and then grouped into an overall sector score. For example, the Telecommunications sector comprises three dimensions: Access, Quality, and Digital Adoption. Access includes variables such as the number of fixed broadband subscriptions per 100 people in the country. Quality includes indicators such as 4G network coverage, and Digital Adoption uses indicators such as the percentage of households that make digital payments.

## METHODOLOGY

The general approach of the development gaps diagnostic tool is to compare the level of achievement measured by an economic or social indicator compared to a calculated “norm” appropriate for the country. For example, to assess the financial development of a country, one common yardstick is the level of domestic credit relative to per capita gross domestic product (GDP). Typically, the wealthier the country, the healthier its credit market.

This scenario is illustrated in Figure 1, where each dot represents a country, with the IDB Group’s borrowing member countries labeled in red.

Figure 1: Domestic Credit to the Private Sector (% of GDP)



1. Borensztein et al. (2014). [Development Diagnostics for the Southern Cone.](#)

For example, the estimated development gap for Trinidad and Tobago (TTO) for this particular indicator is represented by the distance between its observed value and the prediction line (the “norm”) given its income per-capita (shown with the arrow). While many advanced economies achieve levels of domestic credit to GDP close to 100% (or above), the calculated norm for Trinidad and Tobago is about 75%. Rather than comparing to the level prevailing in advanced economies, the development gap for this indicator for Trinidad and Tobago will be a function of the difference between its actual domestic credit to GDP value versus its predicted norm of 75%.



These estimated gaps are then normalized using the differences between observed values and the prediction line for all available countries. Next, all the individual normalized gaps for each country are aggregated within their correspondent dimensions (in this case, access, depth, and efficiency of financial institutions and capital markets), which are then aggregated within their respective sectors. The estimated gaps range from -100 to 100, where a value above zero represents a country that performs better than “the norm” for that specific indicator and values below zero indicate that the country is lagging behind this norm.

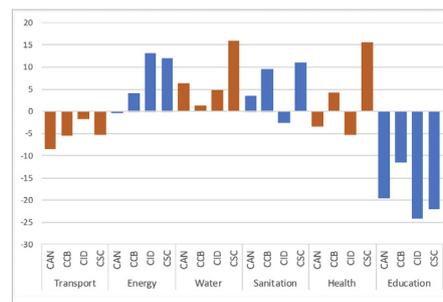


### INFRASTRUCTURE, CORPORATE, AND FINANCIAL DEVELOPMENT GAPS BY REGION

This approach allows for cross-region comparisons. Figure 2 shows the estimated development gaps for the infrastructure sectors across the four IDB Group regions: Andean (CAN), Caribbean (CCB), Central America (CID), and Southern Cone (CSC).<sup>2</sup>

2. CAN: Bolivia, Colombia, Ecuador, and Peru; CCB: The Bahamas, Barbados, Guyana, Jamaica, Suriname, and Trinidad and Tobago; CID: Belize, Costa Rica, El Salvador, Guatemala, Haiti, Honduras, Nicaragua, Mexico, Panama and the Dominican Republic; and CSC: Argentina, Brazil, Chile, Paraguay, and Uruguay.

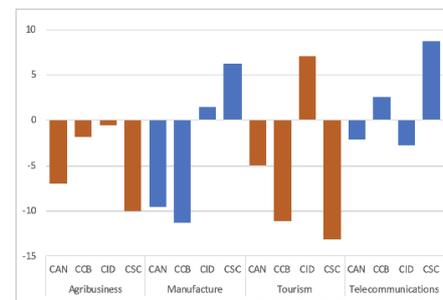
Figure 2: Infrastructure Development Gaps by Region



Regional gaps are derived from the simple average of the countries in each region. Both Transport and Education stand out for having fairly large deficits in all regions. In Transport, the quality of roads and railroads, logistics performance, and the burden of customs procedures are the areas where most regions are lagging relative to expected values, with particularly large negative gaps for Andean countries. In Education, challenges are mainly linked to the quality of (rather than access to) education, with the largest gap observed in Central American countries.

Figure 3 shows that the corporate sectors are generally underperforming. In Agribusiness, the indicators along the dimension of Sustainability bring down the overall index for regions with large gaps (CAN and CSC). In Manufacturing, there is a systematic lag across regions in the economic complexity of their productive structure, suggesting that these countries produce less knowledge-intensive goods and services, using simpler, rather than more complex, networks. Similarly, other areas with deficits are research and development expenditures (as % of GDP) and the proportion of high-tech exports.

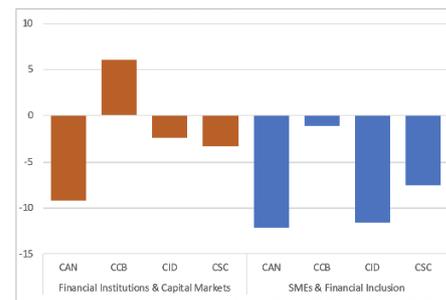
Figure 3: Corporate Sector Development Gaps by Region



On the other hand, for some regions, better measures for CO2 emissions from manufacturing and export diversification partially offset underperforming indicators. Digital adoption is an area where the region is markedly behind. For example, for the use of digital payments, most LAC economies fall below the level predicted by their per capita GDP, suggesting systematic deficits in this area.

Similarly, financial development is behind in all regions, although the banking sector in the Caribbean is more advanced than what its income per capita level would suggest (orange bars in Figure 4). The deficits are pronounced both in terms of the depth and efficiency of financial institutions and capital markets. Countries also have significant gaps in terms of financial inclusion (blue bars in Figure 4), namely access to financial services and credit for households and small and medium enterprises.

Figure 4: Financial Sector Development Gaps by Region



### CONCLUSION

This new framework for the Development Gaps approach helps identify the most glaring deficits in a country or region from “10,000 feet above”. Four of the main development areas where LAC systematically underperforms versus expectations based on countries’ per capita GDP are: economic complexity, transport infrastructure, financial inclusion, and education quality. While this approach does not provide an automatic decision rule, it can help inform decision making for IDB Invest, other MDBs, and investors seeking SDG-related opportunities by highlighting the areas where deeper analysis and more targeted development efforts may be most promising. ■

#### Additional Information

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This brief summarizes the findings of the study by Acevedo M., E. Borensztein and J. Lennon (2019), [Development Gaps: Methodological Innovations and Inclusion of Private Sector Indicators](#), which is part of IDB Invest’s Development through the Private Sector Series.

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