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Interest Bearing Notes | June 2020

A Finance & Private Sector Development Research Newsletter

What's new on our website

Which jobs are most vulnerable to COVID-19?

In a new policy brief, **Daniel Garrote Sanchez**, **Nicolas Gomez Parra**, **Caglar Ozden**, and **Bob Rijkers**calculate labor market exposure to COVID-19 in the European Union (EU) by examining which jobs in non-essential industries cannot be performed from home. Many of these jobs are in lagging regions; tend to be low paid and less secure; and are held by young, poorly educated workers and migrants. For this reason, in the absence of policy action, the COVID-19 crisis is likely to exacerbate preexisting socioeconomic and regional disparities.

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Worldbank research

The transformative effects of privatization in China

The literature on the effects of privatization is large, but two areas that might benefit from further attention are how time-varying firm characteristics affect the timing of privatization (non-random selection), and more detailed, analytically rigorous studies of privatization in China. **Zhangkai Huang**, **Jinyu Liu**, **Guangrong Ma**, and IBN co-editor **Colin Xu** address these issues by exploiting a natural experiment based on the age-promotion rules for local politicians, under which promotion probability drops sharply after age 58. Using a regression discontinuity framework, the authors find that cities with top politicians older than 58 were significantly less likely to privatize SOEs under their oversight, presumably because the political advancement associated with privatization was no longer possible. To address the selectivity of privatization with respect to firm performance, they use a dummy variable indicating that the top local politician was 58 or older as the instrumental variable for privatization. They offer evidence that this instrumental variable does not show a significant correlation with SOE performance, consistent with it satisfying the exclusion restriction. They then show that their instrumental variable estimate of the causal effects of privatization is an order of magnitude larger than those obtained from the traditional firm-fixed-effect specifications. Furthermore, where the local government is more actively involved in developing local businesses, the effects of privatization are significantly smaller, indicating complementarity between privatization and marketization. This paper indicates that privatization is a key reason behind China’s economic transformation.

Female business leaders, the business and cultural environment, and productivity

While women are beginning to get ahead of men in selective areas, such as college admission, in both high-paying and leadership jobs, women continue to lag men. **Sheng Fang**, **Chorching Goh**, **Mark Roberts**, **Albert Zeufack** and IBN co-editor **Colin Xu** use worldwide firm-level data from the World Bank Enterprise Survey to study how female-headed firms differ from male-headed firms in their productivity levels and growth, and whether male-female leader performance disparities hinge on the underlying environment. They find that female-headed firms are more prevalent in countries with better rule of law, greater gender equality, and a stronger individualistic culture. After conditioning on basic country-and firm-level characteristics, female-headed firms have significantly lower productivity levels and labor productivity growth than male-headed firms. The disadvantage derives from manufacturing firms but is hardly evident among service firms, and it shows up only among relatively small firms. Although the female leader performance disadvantage is not related to gender equality, it is smaller where there is less emphasis on personal networks, less competition, and the culture is more collective. Contrary to the literature showing that corruption can have particularly adverse effects on women, the study does not find that the female leader disadvantage is amplified in corrupt environments.

Winners and losers when private banks distribute government loans

Our own **Alvaro Pedraza** and **Claudia Ruiz-Ortega**, together with J**ose Renato Haas Ornelas** and **Thiago Silva** analyze the effects of Brazil's earmarked credit program, one of the world's largest second tier lending programs, under which a substantial portion of the funds were transferred from the Brazilian National Development Bank to private banks that then selected loan recipients. These earmarked loans were intended to complement banks' commercial lending but had regulated interest rates set below the average market rate. To mitigate the negative effects from the Global Financial Crisis and to alleviate credit constraints among micro, small, and medium size firms, in 2008 the Brazilian government substantially expanded the program. The authors consider two types of loans – working capital and vehicle financing – which accounted for roughly half of the total outstanding volume of private credit to businesses. While the purchase of vehicles can be financed via loans from both the 'free' market and the earmarked credit market, working capital loans are almost exclusively accessed in the free market. Using data from 5.8 million loans to 1.85 million firms from 2005 to 2016, the authors find evidence that banks offset some of the lower expected revenue from government loans by increasing their interest rates on other credit products. Specifically, once an earmarked loan was received, the recipient firm experienced an average increase of 38 basis points on the interest rates on new working capital loans contracted with the bank. There was not a similar interest rate increase in the sample of vehicle loans, where earmarked and commercial loans were both prevalent, and banks had less flexibility to adjust rates. Moreover, increased rates on working capital loans were only observed among high-risk firms – those with below-median credit ratings, for which banks were required to hold more provisions. Thus, riskier borrowers received earmarked loans only if they paid a premium for other non-earmarked loans. Finally, although the expansion of the program was meant to promote investment among micro, small, and medium enterprises, it was larger firms and those with existing credit relationships with the largest banks in the country that disproportionally benefited from the loan subsidies. The patterns are consistent with a risk mitigating strategy, under which banks bearing the credit risk associated with

earmarked loans at a capped interest rate had a strong incentive to select borrowers that were ex-ante less risky.

Remote-learning, time-use, and mental health of Ecuadorian high-school students during the COVID-19 quarantine

Our own **David McKenzie** along with **Igor Asanov**, **Francisco Flores**, **Mona Mensmann**, and **Mathis Schulte** conduct a rapid response phone survey among high school students in Ecuador to understand and learn about their time use during quarantine, and to understand their access to remote learning opportunities. The findings show that most students have developed daily education routines, with 74 percent engaging in some online or telelearning activities. Female students spend more time on schoolwork and are also responsible for more household tasks; meanwhile, male students are more likely to be working than their female counterparts. The survey also includes questions to measure the mental health status of students, who identify disruptions to learning and social isolation as their two biggest concerns due to COVID-19. In addition, 16 percent have mental health scores that lie below a threshold indicative of major depression, which suggests scope for social support programs and interventions to supplement remote learning.

Financing firms in hibernation during the COVID-19 pandemic

In past crises, policy makers have tried to resolve the financial intermediaries, creditors, and firms in trouble, while shielding the rest of the financial system and the real economy from a collapse. **Tatiana Didier**, **Federico Huneeus**, **Mauricio Larrain**, and **Sergio Schmukler** point out that this approach is ill-suited to dealing with the generalized shock of the COVID-19 pandemic on firms and financial systems. They remind us that firms depend on key and unique relationships with different stakeholders, such as workers, suppliers, customers, and creditors. These relationships are costly and time-consuming to build, maintain, and adjust, and therefore difficult to re-create. An overarching goal should be to work with the financial sector to improve the likelihood that viable firms are not pushed into default and bankruptcy by a financial infrastructure that is not prepared to deal with a pandemic. While some commentators favor a “freeze” of the economy until the health crisis abates, the authors favor “hibernation,” which means using the minimum cash necessary for firms to withstand the lockdown and the social distancing measures. That cash could be used to freeze firms’ relationships with their stakeholders, while adapting their activities, but not to freeze firms themselves. They go on to discuss specific policies for adapting the institutional framework to meet the challenges imposed by the pandemic and others regarding the provision of credit to firms. The choices here will not be easy ones. Should support go to large firms (which have many workers, but better access to alternative sources of finance) or to small firms? Or to firms in essential industries versus the hardest hit? Or to those whose failure would be most disruptive to value chains, or those whose relationships would be most difficult to reconstruct? Country context matters greatly for how these questions are answered. Emerging and developing countries face sudden reductions in capital inflows, additional debt will be pricey, and many have depreciating currencies (and firms with loans denominated in foreign currency). Those factors limit the range of solutions available. That said, many developing countries have banking systems that they could use to channel credit to firms and tools to assist banks, and the prevalence of informal firms might help them reestablish relationships

faster once the lockdown measures are eased. These informal firms might be better targeted through programs that assist households, through cash transfers and personal loans.

Measuring employment: Experimental evidence from urban Ghana

Rachel Heath, **Ghazala Mansuri**, **Bob Rijkers**, **William Seitz**, and **Dhiraj Sharma** conducted a randomized survey experiment in Ghana to assess the impact of the reference period and survey modality (being interviewed over the phone) on measures of employment. The experiment tracked 954 respondents of the Ghana Urban Household Panel Survey. Respondents were randomly allocated to one of three groups (a) a group that was interviewed by phone three times a week for 10 weeks, (b) another that was interviewed by phone once a week for 10 weeks, and (c) a third that was interviewed in person once a week for 10 weeks. The results show that both survey modality and the reference period matter for measuring employment, particularly for the self-employed in mobile or home-based self-employment. On average, interviewing respondents over the phone instead of in person reduced the reported incidence of employment by 8 percentage points, the number of days worked by 0.6 and the number of hours by 7. One potential explanation for this finding is that respondents feel less compelled to report socially desirable outcomes over the phone than in person. With regards to the reference period, those interviewed over the phone three times a week were 7 percentage points more likely to report having done any work than those interviewed over the phone once a week. Conditional on reporting any work, they reported 0.6 fewer days and 4.7 fewer hours than those interviewed once a week. Shorter reference periods thus appear to allow respondents to better recall shorter employment spells.

Our eclectic guide to recent research of interest

COVID-19 and the future of microfinance: Evidence and insights from Pakistan

Kashif Malki, **Muhammad Meki**, **Jonathan Morduch**, **Timothy Ogden**, **Simon Quinn**, and **Farah Said**provide new and timely evidence on the implications of COVID-19 for the microfinance sector in Pakistan. Pakistan has a mature microfinance sector that serves a wide distribution of businesses and households, and as such these findings are important and relevant for other settings. The authors report results from rapid response phone surveys of 1,000 microfinance clients, along with a survey of 200 microfinance loan officers, and qualitative evidence from interviews with regulators and senior representatives of microfinance institutions. They find massive drops in weekly sales and household income among the microfinance clients – a drop of about 90 percent. The respondents report their primary concern as being able to acquire food for their household, and 70 percent report an inability to repay their loans. This latter finding is confirmed by the loan officer surveys, which report loan repayment rates fell from 98 percent in February 2020 to 81 percent in March 2020 and were predicted to fall precipitously to 34 percent by April 2020. This drop in repayment, in turn, has caused a liquidity crisis among the microfinance providers who are unable to service their investors. The qualitative interviews suggest a need for a concerted effort by investors, regulators, and other public service actors to stabilize and manage liquidity under the pandemic emergency.

Resisting social pressure in the household using mobile money

Emma Riley studies whether changing the way loans are disbursed impacts the businesses of female borrowers. In a randomized control trial in Uganda, 3,000 female microfinance clients were randomly allocated to one of three groups (1) a treatment group that received their microfinance loans in cash and received a mobile money account explicitly designated for the woman's business (2) a second treatment group that received their loans deposited into a mobile money account and (3) a control group that received their microfinance loan as cash and was not given a mobile money account. Emma argues that, when loans are disbursed in cash, family may expropriate funds away from the woman's business. Instead, women may be more likely to resist sharing pressure when loans are deposited into a private mobile money account. Results from a follow-up survey, conducted 8 months after loan disbursement, show indeed that women who received their microfinance loan through the mobile money account had 15% higher business profits and 11% higher levels of business capital than women in the control group. These impacts were greatest for women who experienced pressure to share money with others in the household at baseline. Receiving a mobile money account on top of cash loan payments had no effect on business outcomes.

Upcoming events and miscellanea

Conference on Political Economy of Finance 2020 - Should Corporations Have a Social Purpose?

The Stigler Center at the University of Chicago Booth School of Business is launching the fourth conference on the *Political Economy of Finance*. The conference is open to theoretical and empirical contributions on themes including corporate social responsibility, the purpose of corporations, ESG objectives, the interaction between politics and business, and more. Papers may be submitted by visiting the Ex Ordo paper submission system (please note that you will be required to set up an account first): **https://pef2020.exordo.com**. The deadline for submissions is July 19, 2020. In accordance with University of Chicago guidance on COVID-19, the conference will be held virtually in a series of webinars throughout September 2020.

Special Issue "Financial Literacy and Financial Education"

The *Journal of Behavioral and Experimental Finance* is inviting submissions to a special issue titled "Recent Developments in Financial Literacy and Financial Education." The deadline is June 30, 2021. Articles will be published in the journal upon acceptance like regular articles and will thus not have to wait for the entire special issue to be compiled. In addition to publication in regular journal issues, articles will also be published together in a virtual special issue, available both online and for print-on-demand.

Call for papers: Special issue on Fintech's Impact on Payments

The Journal of Payments Strategy & Systems will publish a special issue on Fintech's Impact on Payments. This issue will take stock of current developments and initiatives and will reflect on the medium- and long-term impact of Fintech on payments. The deadline for submitting a practice article or research paper is August 18, 2020.

Call for papers: World Finance & Banking Symposium

The World Finance & Banking Symposium (2020) will take place in Riga - Latvia on December 3–4, 2020. The conference is hosted by the Faculty of Business, Management and Economics at the University of Latvia and is open to submissions in all areas of finance, banking and economics. The deadline for submitting a paper is September 7, 2020.

Happy reading!

Your editors Miriam Bruhn (mbruhn@worldbank.org), Bob Cull (rcull@worldbank.org), Colin Xu (lxu1@worldbank.org), and Bilal Zia (bzia@worldbank.org)

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