WORLD BANK GROUP

Interest Bearing Notes | **February 2021**

A Finance & Private Sector Development Research Newsletter

What's new on our website

A novel approach to support firms

In a recent All About Finance blog post, **Arti Grover** discusses lessons learned from firm support programs. Many of these programs intervened to address one constraint at a time. Arti proposes a novel three-stage “graduation” or “funneling” approach for addressing multiple constraints to firm growth.

World Bank research

Improving business practices and the boundary of the entrepreneur

Many small firms lack the finance and marketing skills needed for firm growth. The standard approach often is to attempt to train the entrepreneur to develop these skills, through classroom-based training or personalized consulting. Our own **David McKenzie**, together with **Stephen J. Anderson** used a randomized experiment in Nigeria to test two different approaches: insourcing workers and outsourcing tasks. The authors randomly assigned 753 firms (each with 2-15 workers) to a control group and four treatment groups: (i) in-class business training, (ii) subsidized consulting, (iii) insourcing, which linked firms to human resource service providers, who helped them recruit an accounting or marketing specialist as a full-time worker and (iv) outsourcing, which linked firms to accounting and marketing service providers. The salary of the insourced worker and fees of the outsourced professional were subsidized for nine months. Initial take-up rates were over 90% in all treatment groups, although not all firms completed the treatment. Results from two follow-up surveys, conducted 1 and 2 years after the interventions started, show that in-class training did not have a statistically significant impact on business practices, nor on firm growth. In contrast, the other three treatments led to significant improvements in a range of business practices (including a physically verified subset). Two years after the intervention, the outsourcing treatment resulted in a statistically significant increase in profits and sales. The estimated impacts on profits and sales are smaller and not statistically significant for insourcing and consulting, but the authors cannot reject equality of impacts across these treatments. Overall, insourcing and outsourcing both dominate business training, and do at least as well as consulting at one-half of the cost.

Learning to navigate a new financial technology: Evidence from payroll accounts

In a new field experiment on payroll accounts among garment workers in Bangladesh, our own **Martin Kanz** and **Leora Klapper**, together with **Emily Breza**, study the impact of electronic wage payments on a variety of outcomes related to savings, financial literacy, and consumer protection. The treated group received their payments directly in a bank or mobile money account, while the control group continued to receive payments in cash. The findings show that exposure to automatic deposits leads to increased savings, improvements in the ability to cope with economic shocks, and adoption of a wider set of account features. The authors additionally conduct an audit study to identify general equilibrium effects and find that recipients of electronic wage payments are also more protected from predatory lending practices of mobile money agents. These findings suggest a strong "learning by doing" mechanism whereby users of payroll accounts learn about new account features and can insulate better from illicit fees and other predatory practices. Furthermore, the findings show that the learning and consumer protection impacts are accompanied by an increase in trust of the financial system, which can have broader impacts on savings at banks and boost bank-level liquidity.

Macroeconomic expectations and credit card spending

Our own **Martin Kanz**, together with **Mikhail Galashin** and **Ricardo Perez-Truglia**, conducted a field experiment with credit card customers from a large bank in Malaysia to study how macroeconomic expectations affect consumer decisions. The study first elicits respondent expectations on inflation rates and exchange rates, which is then followed by a random subset receiving precise and expertly crafted forecasts of these two measures. The study then follows these individuals with survey questions on posterior beliefs and self-reported spending patterns, as well as matched administrative data on credit card spending. The findings show that, while individuals update their expectations based on expert knowledge they receive, this additional information does not affect their actual spending behavior. The authors interpret these findings to suggest that consumers are not sophisticated enough to optimize their spending based on revised macroeconomic expectations. These results show a tenuous causal link between macro indicators and consumer behavior, which is often assumed in macroeconomic models.

Opening-up and economic recovery after the first wave of the COVID-19 pandemic

Asli Demirgüç-Kunt, **Michael Lokshin**, and **Iván Torre** explore how the timing, sequencing, and speed of the reopening of economies in Europe and Central Asia have affected the path of recovery after the onset of the COVID-19 pandemic. They find that gradual reopening is associated with a stronger recovery, and that starting the reopening process too early (with respect to the pandemic's first peak) tended to slow the recovery. They also find that higher levels of trust in government institutions within society are associated with increased economic activity among countries that carried out a gradual reopening process, and that fear and anxiety about the spread of the pandemic (as reflected in Google searches for the terms "death," "infection" or "COVID") may have hindered economic recovery. To address potential endogeneity in governments' decisions on the timing of reopening, the authors replaced the observed reopening waiting time with a simulated reopening based on either (1) the assumption that countries started the reopening process after two weeks of downward trajectory in the number of COVID-19-infection cases, in line with EU Council guidance about the timing of reopening borders to non-EU countries or (2) the average wait duration in neighboring countries weighted by the distance to these

countries. Either method indicates that the beneficial economic effects of gradual reopening over a fast reopening are robust to controlling for potential endogeneity in the timing of reopening. Results are also robust to controlling for economic conditions in countries prior to the COVID outbreak. As countries reopen their economies in the wake of the second wave of the pandemic, these results underscore that a careful, gradual, and transparent reopening is likely to be optimal in both minimizing the health costs of the pandemic and increasing the chances of a faster recovery.

Bilateral international investments: The Big Sur?

Combining information from various databases on bilateral international investments, including bank loans and deposits, portfolio investment in debt and equity, foreign direct investment (FDI), and international reserves, **Fernando Broner**, **Tatiana Didier**, **Sergio Schmukler**, and **Goetz von Peter** document how the global South – that is, countries outside the G7 and Western Europe – has come to play an increasingly important role in global finance. Unlike studies that rely on the aggregate investment positions of countries with respect to the world, the authors rely on bilateral data that sheds light on both the source and destination of international investment. They show that the share of total global investment involving the South (North-to-South, South-to-North, and South-to-South investments) increased by about ten percentage points between 2001 and 2018 for international loans and deposits, portfolio investment, and FDI. Though it still comprises a smaller share than investments between North and South, South-to-South investments grew at the fastest rate during this period. For FDI and loans and deposits, the share of South-to-South investment in the global total doubled between 2001 and 2018, from about 6 to 13 percent. The share of South-to-South portfolio investment and international reserves grew even faster, more than quadrupling, though it started from a low base (about one percent of global investment in 2001). They also show that the financial integration of the South developed along both the intensive margin (the value of investment for links that had been established by 2001) and the extensive margin (the number of bilateral links) for each investment type, though the changes in global shares were driven primarily by increases on the intensive margin. Moreover, these patterns are not driven by just a handful of countries, as they are robust to excluding China and the 20 richest South countries from the analysis.

Our eclectic guide to recent research of interest

Asset-based microfinance for microenterprises: Evidence from Pakistan

Faisal Bari, **Kashif Malik**, **Muhammad Meki**, and **Simon Quinn** worked with a large microfinance institution (MFI) in Pakistan to pilot an asset-based loan product. The study sample comprised 757 microenterprise owners who had successfully completed at least one loan cycle with the MFI, reached the maximum permitted borrowing amount, and expressed an interest in expanding their business by purchasing a fixed asset. Participants were randomly assigned to one of three groups: (i) a control group, who was eligible for a $475 zero-interest loan (the standard upper borrowing limit for the MFI); (ii) treatment group 1, who was offered a fixed-repayment hire-purchase contract to purchase an asset up to the value of $1,900 (and could also reject the offer and receive the same loan product as the control group); (iii) treatment group 2, who was offered a flexible-repayment hire-purchase contract to buy an asset up to the value of $1,900, but was free to reject the offer of flexibility and take the fixed-repayment

contract (and was also free to reject both contracts and take the $475 zero-interest loan). The take-up rate for the asset-based products was 57% on average, and the default rate was under 5% for both contracts. Data from five rounds of follow-up surveys conducted during the two years after the intervention show that both treatment groups were more likely to remain in self-employment, had more business assets, and better business management practices (particularly in terms of inventory control and purchasing) than the control group. Both treatments increased monthly business profits by about 9%, monthly household income by about 8% and monthly household consumption expenditure by 6%.

Political parties as drivers of U.S. polarization

Nathan Canen, **Chad Kendall**, and **Francesco Trebbie** study the role of the two main political parties and their leadership in driving the sharp increase in political polarization in the United States over the last ninety years. In particular, they assess the extent of the influence that party leaders exert on the behavior of rank-and-file members as they drive the passage of laws, while also creating wedges between lawmakers belonging to different parties. Distinguishing politicians' ideology from party leaders' coordination (using discipline and other means) is empirically challenging, and so the authors develop a novel identification strategy that requires information on congressional vote choices and on the party leadership positions on each vote. Their key findings are that political party influence is an important driver of observed polarization in congressional voting behavior and that the leaderships of both parties have played a similar role in driving an increasing wedge between groups of politicians. They estimate that party leaders have been responsible for approximately 65% of the polarization in congressional voting in recent decades in both the Senate and in the House – and the phenomenon appears symmetric between the parties. They also observe that increases in party discipline are positively correlated with within-party ideological homogeneity.

History's masters: The effect of European monarchs on state performance

The Scottish historian and writer Thomas Carlyle famously said, "the history of the world is but the biography of great men." In contrast, the Marxist tradition argues that it is structural demographic and economic forces that determine a nation's performance. Which view is more credible? **Sebastian Ottinger** and **Nico Voigtländer** have collected a novel reign-level dataset for European monarchs, covering all major European states between the 10th and 18th centuries, which they use to document a strong positive relationship between rulers' intellectual capabilities and state-level outcomes. Recognizing the endogeneity of rulers' capacity, they code an instrument based on the degree of blood relationship between the parents of rulers. This 'coefficient of inbreeding' proves a strong predictor of ruler ability, and the corresponding IV estimates imply that ruler ability had a sizeable impact on the performance of states (as subjectively judged by historians) and the size of their borders (as an objective measure). This supports the view that 'leaders made history,' shaping the European map until its consolidation into nation states in the 19th century. The authors also show that rulers' ability mattered only where their power was largely unconstrained. In reigns where parliaments checked the power of monarchs, ruler ability was not significantly associated with the state's performance.

Upcoming events and miscellanea

Call for Papers: Corporations and Covid-19

The European Corporate Governance Institute (ECGI), in collaboration with the University of Oxford, the Review of Corporate Finance Studies (RCFS) and the Review of Financial Studies (RFS), is organizing an online workshop on “Corporations and Covid-19” on June 17, 2021. The submission deadline is April 9, 2021. Both fully developed papers and paper proposals are welcome.

Call for papers: New Perspectives on Consumer Behavior in Credit and Payments Markets Conference

The Consumer Finance Institute and the Research Department of the Federal Reserve Bank of Philadelphia are co-organizing their 11th biennial conference focusing on new research in consumer credit and payments. The conference will be held at the Federal Reserve Bank of Philadelphia or online on September 9–10, 2021. The deadline for submitting a paper is June 1, 2021.

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)

IBN is a product of the Finance and Private Sector Development Team in the World Bank's Development Research Group. Our working papers and descriptions of research projects in progress can be found, along with a list of forthcoming seminars and conferences, on our web page

Please send comments, suggestions (such as your own or others’ interesting research) toibnnewsletter@worldbank.org

To learn more about us, click here

Follow us on