

Lessons from Evaluations

Support and Financing to the Formal Private Sector in Response to COVID-19

Independent Evaluation Group | July 2, 2020

How can the World Bank Group help keep the formal private sector alive during the current coronavirus (COVID-19) crisis? Beyond its impact on public health, the novel coronavirus is taking an unprecedented economic toll, damaging businesses and livelihoods through several channels. Supply-side disruptions to global and local value chains combined with the loss of trade and transport led to a sharp reduction in demand due to idle factories and businesses and loss of household income and mobility. The difficulties of maintaining business are compounded by credit drying up and financial market contraction.

This note identifies core lessons for the Bank Group on addressing the impact of the crisis on business and enterprises, based on evaluative evidence from the Independent Evaluation Group (IEG). It particularly draws on Bank Group experiences in addressing earlier crises, including the global economic crisis of 2008–10, the food crisis of 2007–8, and the East Asian crisis of 1998. It also reviews evidence from responses to other systemic shocks, such as natural disasters and crises arising from conflict. However, it does not reinterpret past findings in light of subsequent developments. Lastly, it incorporates IEG's broader evaluative findings on instruments that support business and market development. It complements other IEG notes on crisis response topics under preparation, including those on distressed assets and trade finance.

The Private Sector Needs Help Quickly; The World Bank Group Must Act Fast

Using World Bank fiscal support tools. For the World Bank, support for the private sector usually passes through government. During a crisis, when speed of response is paramount, this means fiscal support. Although the International Finance Corporation (IFC) is already engaged with private banks and businesses, most World Bank lending is to governments or through government-guaranteed lending. For World Bank support to enterprises in the real sector, quick-disbursing loans for fiscal support—preferably accompanied by eased national monetary policies to enhance liquidity—are more appropriate than investment lending (box 1). In development policy loans, lending to support past policy reform can be usefully supplemented with countercyclical fiscal support as a recognized objective (World Bank 2012c). Typical slow-disbursing investment lending does not

ensure a timely distribution of resources and positive net resource transfers (ADB 2012; World Bank 2011, 2012c). Instead, governments—provided they have the fiscal space—can prioritize and channel such World Bank lending to banks and businesses through maintaining staff payroll, income support or new hire subsidies, public guarantees, loan forbearance, working capital, credit, or other needs.

Box 1. Crisis Experience with Policy-Based and Budget Support Instruments

Among quick-disbursing budget support instruments, World Bank lending linked explicitly to countercyclical fiscal support can be better adapted to crisis situations. During the global economic crisis, the World Bank used traditional policy loans tied to policy achievements. Such lending can be usefully supplemented by lending that is linked explicitly to countercyclical fiscal support to provide governments with a buffer against adverse events (such as a run on the currency; World Bank 2012c). During the global economic crisis, other international finance institutions (IFIs) had such instruments, but the World Bank could not lend explicitly to stabilize markets. The World Bank's Emergency Structural Adjustment lending instrument, introduced in October 1998, although not intended to provide liquidity support, recognized market stabilization as a goal. Countercyclical support for better performing countries can be considered without a need for support from the International Monetary Fund (IMF) or other IFI and multilateral development bank consortiums. Though rare, when individual country capacity was deemed high and the country policy environment favorable, the World Bank provided flexible budgetary support not tied to agreed policy reforms (World Bank 2018).

The World Bank and other IFIs have effectively used budget support loans with contingent features during crises. First, in anticipation of difficulties, the deferred drawdown option (DDO) was effectively used during the global financial crisis at both the World Bank and the Inter-American Development Bank (World Bank 2012c; IADB 2016). The DDO gives an International Bank for Reconstruction and Development borrower the option of deferring disbursements under a development policy loan (DPL) for up to three years (renewable for an additional three years with Board of Executive Directors approval), provided that its overall development policy program implementation and macroeconomic policy framework remain adequate. The World Bank approved 17 DPL DDOs between April 2008 (only three by September 2008) and December 2009, compared with an uptake of only two such operations in the years before 2008. Second, other IFIs used instruments known as flexible credit lines. Apart from the IMF Flexible Credit Line, the IADB created a Contingent Credit Line for Natural Disasters and increased the limits available under its Contingent Credit Facility for Natural Disaster Emergencies, established in 2009 (IADB 2016). These provided a line of credit the country could draw on as needed. By providing a contingent option, these instruments are conceptually similar to a DDO but without the need to draw the full amount.

The World Bank can make better use of specific crisis instruments with maturities, rates, or other terms to reflect the higher risk and likely shorter-term needs. During the 2008 crisis, other multilateral development banks and IFIs made greater use of such special instruments. The Inter-American Development Bank raised its spreads and applied them to existing loan balances and new loans, extending \$3 billion

on special crisis lending terms. The Asian Development Bank used its Countercyclical Support Facility to extend loans to six countries at above-normal prices, with shorter maturities and not requiring an IMF program. The African Development Bank introduced an Emergency Liquidity Facility, priced similarly above regular loans and with a lower maturity. The IMF continued its significant premiums for larger drawings and added incentives for timely repayment. Ex post evaluations (for example, ADB 2012) found that such crisis facilities also offer greater flexibility to IFIs in designing support and minimize the trade-off with normal lending—although they should be used with caution. The International Bank for Reconstruction and Development's special development policy loan had some of these features but required an IFI consortium and a disbursing IMF program be in place, partly explaining why it was used only once for a crisis loan.

Policy-based quick-disbursing loans, especially in the absence of specific crisis features, tend to exhaust capital headroom. Therefore, shareholders need to be alerted to possible capital impacts that could lead to subsequent recapitalization in the medium term. Balance sheet impacts of crisis lending were recognized in all the IFIs after the global economic crisis (ADB 2012; World Bank 2012c).

Investment lending, which tends to disburse slower than budget support, can disburse faster when the World Bank moves toward quicker-to-implement investment lending vehicles. Investment lending allows more direct engagement with financial institutions and enterprises. During crises, the World Bank has shifted to rely more on projects relatively easy to prepare and negotiate. In 2008, the World Bank's global economic crisis response reduced the time it took to prepare projects for appraisal and Board of Executive Directors approval through greater reliance on additional financing and simple and repeater projects. Although regular investment lending took an average of 18.3 months for approval, additional finance took 6.2 months and simple and repeater projects took 12.8 months (World Bank 2012c). The number of loans with additional financing increased from 25 percent precrisis to 32 percent in the crisis period. Simple and repeater projects rose from an average of 71 projects per year precrisis to 114 projects per year during the crisis period, rising from a precrisis average of \$3.4 billion in commitments to \$9.5 billion.

A 2012 IEG evaluation found that in a rapid response to keep the private sector alive, IFC should focus on those programs and instruments where there is already a precedent of success and rapid mobilization during crisis (World Bank 2012c). New instruments may be appropriate for the medium term. New crisis initiatives introduced by IFC in 2008 required significant set-up time and lagged in implementation. IFC's Global Trade Finance Program, an existing facility, was successfully able to extend guarantees to international banks to cover risks related to trade finance, doubling its ceiling, reaching out to new corresponding banks, and gearing up coverage of South-South

trade and smaller small and medium enterprise (SME) transactions.¹ However, IFC launched a significant number of new initiatives (some global) to support the private sector during the global crisis that were less effective as short-term responses to crisis as a result of delays in becoming operational. Setup time and lags in implementation limited their use as short-term responses. These include a World Bank Recapitalization Fund and the Debt and Asset Recovery Program,² both established in 2009. Both had mixed early results. The Infrastructure Crisis Facility only became operational once there was a marked decline in the severity of the crisis. Similarly, the Global Trade Liquidity Program took some time to obtain partners' final authorization and funding, to ramp up operationally, and to have issuing banks build capacity. As a result, the target disbursements were not met in fiscal year 2009, although by 2010 actual disbursements reached \$1.5 billion (World Bank 2012c). The Microfinance Enhancement Fund, after initial delays, provided important assistance to microfinance institutions facing liquidity issues.

State-owned enterprises (SOEs) should be used with caution, given the risks associated with underfunded subsidies and weak governance. Several of the World Bank's private sector support projects during the initial response to the COVID-19 crisis are channeled through state development banks. Many governments channel subsidies or benefits through SOEs, such as deferred payment of utility bills or subsidized credit to enterprises. The literature does provide some explicit warnings. First, temporary subsidies and benefits after crises may be "policy traps" that are politically difficult to reverse (Bril-Mascarenhas and Post 2012). IEG research indicates that unfunded or underfunded subsidies can undermine the financial sustainability of SOEs. Second, use of state-owned banks to respond to crises may be costly and inefficient. The *World Bank Group Global Financial Development Report 2013* found that although SOE lending in the global financial crisis may have been "less procyclical" than private lending, it "did not always target the most constrained borrowers" and it was associated with a "deterioration of the quality of financial intermediation" (World Bank 2012a, 2, 12). Special attention must be paid to governance, including assuring "adequate risk management processes are in place" (World Bank 2012a, 101).

It Is Vital the Chosen Instruments Reach the Distressed Enterprises

Although financial intermediary loans (FILs) have been widely used for crisis response, little evidence indicates that their financing reaches the enterprises worst hit by crisis or disburse in a timely manner. Few FILs disbursed rapidly, and monitoring has been weak (World Bank 2012c, 2017a). Attempts to reach affected enterprises directly during past financial crises used a substantial

¹ See IEG Real Time Learning Note *Lessons from Evaluations of IFC's Global Trade Finance Program*.

² A description of the program's results in the medium term will be presented in the forthcoming IEG learning note on managing distressed assets.

increase in lines of credit through participating financial intermediaries to private borrowers. About a third of the 77 financial sector loans and commitments during the 2008 global economic crisis were lines of credit. They aimed to increase bank credit to the private sector groups most affected by the crisis: small and medium enterprises, exporters needing trade finance, rural businesses, and cooperatives. However, they faced several challenges:



Few FILs could be disbursed rapidly, although loans to institutions with World Bank experience, repeat loans (select FILs to Turkey and India), and loans to exporters (for example, Croatia) disbursed faster than others. Many took a long time to prepare, and several had long lags to effectiveness and little or no disbursement within the first 12 months.



Targeting was an ongoing problem (World Bank 2014a). IEG found a lack of systematic tracking of beneficiary targeting in many FILs (World Bank 2012b). Although the stated objective of 10 of 16 global financial crisis response FILs was to increase bank credit to those private entities most affected by the crisis (SMEs, exporters needing trade finance, and rural businesses and cooperatives), they mostly failed to provide "concrete evidence" and only 1 in 5 provided relevant information in their documentation (World Bank 2012c). A second evaluation, *Industry Competitiveness and Jobs*, found that sustained outreach to small and rural enterprises was difficult (World Bank 2016). IFC credit lines too have suffered from difficulties in targeting (World Bank 2014b, 2019d).



The ex post monitoring of additional financing components involving FILs was weak and, in many cases, was not reported in project completion documents (World Bank 2010).



FILs intermediated by large government-owned banks and apex financial institutions may help in the short term but make limited contributions in the medium-term. Loans to apex institutions (which were often more experienced or more prepared to play a countercyclical role) without the involvement of second tier partner financial institutions were some of the fastest disbursing. Yet the potential countercyclical role of government-owned banks is countered by the risk of political capture, a deterioration of loan quality, and nonoptimal allocation of resources. Postcrisis activity of state-owned banks "did not always target the most constrained borrowers" and is associated with a "deterioration of the quality of financial intermediation" (World Bank Group 2012a, 12).

The World Bank has used other instruments to support businesses, but few have been tested in a crisis context or with large firms. Reaching out to micro, small, and medium enterprises poses additional challenges due to their limited size and bargaining power, which can add to the cost of delivery and reduce the likelihood of their accessing assistance (World Bank 2019e). For micro, small, and medium enterprises, matching grant project components financing technical assistance for business development services or other business upgrading are generally rated successful, though success is poorly defined. Delivery of business development services appears to help improve firm performance and create jobs, but there remains a limited understanding of the mechanisms by which this works. Such an understanding would be crucial to designing SME interventions for different contexts. Next, partial credit guarantee schemes that cover a share of the default risk of loans have generally been found to add value, but their sustainability depends on the strength of countries' institutional frameworks.

Businesses Can Benefit from the World Bank Group's Understanding of Their Constraints

The Bank Group can provide valuable support to clients after crisis when it grounds its response in its existing stock of knowledge or new analytic and advisory work (World Bank 2010). This knowledge can be used to aim interventions at key constraints and ensure that funds are directed to their best use through accompanying knowledge and analytical work. During the global crisis, the World Bank increased public finance-related analytic and advisory work related to its budget support. In some countries (Indonesia, Mauritius, Mexico, and Ukraine), earlier analytical work provided a platform for the World Bank response, in some cases in conjunction with international support packages (World Bank 2010). However, in client countries where precrisis engagement was low, knowledge gaps left the World Bank unprepared to help map out actionable, forward-looking programs, and the quality of lending suffered (World Bank 2012c). In situations of fragility and conflict, country-level Risk and Resilience Assessments can complement standard private sector diagnostics to shed light on key drivers of fragility and areas of Bank Group support to mitigate and address these risks (World Bank 2013, 2019c).

Quality at Entry is Key to Delivering Benefits to the Private Sector

Building on prior engagements can guard against the risk that rapid project preparation lowers quality at entry. Low quality at entry can reduce development impact and sustainability. Evaluations of previous World Bank crisis lending provide mixed evidence on the quality at entry of projects prepared on an expedited basis (World Bank 2010, 2013). In the Bank Group's better responses to the food crisis, quality at entry was enhanced in projects providing additional or

supplemental financing congruent with an existing project. They avoided tacking on crisis components unrelated to the existing project and maintained strong internal review. In response to the global financial crisis, quality was higher where there had been prior country engagement (World Bank 2010). The World Bank was generally able to maintain average quality during the financial crisis, but it suffered in some sectors (financial and infrastructure) and wherever preparation resources remained flat in the face of high pressure on staff to deliver quickly. IFC suffered some design and implementation weaknesses, especially regarding monitoring and evaluation (World Bank 2012c).

When the Crisis Is Over, the Private Sector Still Needs Support

Even when responding to crisis, longer-term planning focused on long-term restoration of growth and employment and sustainability of responses is needed. First, a strategic road map for crisis engagement should sequence interventions from short term to longer term (World Bank 2019c). Better longer-term internal planning by the Bank Group is also needed for combating short-term crises (World Bank 2012c). Such a road map should be based on ongoing systemic analysis of stress factors, a framework for coordination with other international finance institutions, and a review of instruments for effective crisis support, meaningful growth, and medium-term development. Furthermore, the Bank Group should consider strengthening its internal coordination of crisis response to promote better knowledge sharing across its units (World Bank 2017a). Finally, during any crisis, ensuring the sustainability of responses is key. This was an explicit objective—and success factor—of the Global Food Crisis Response Program (World Bank 2013).

In summary, the lessons suggest a need to find ways to act fast to support the private sector, to ensure that assistance reaches those enterprises in distress, to build on prior knowledge of business conditions and constraints, to maintain quality at entry, and to understand that restoration of growth and employment requires a sustained response.

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