Business Environment Reforms to Improve Economic Resilience to Global Shocks

Business Environment Working Group

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Acronyms

COVID	Coronavirus disease
DCED	Donor Committee for Enterprise Development
GDP	Gross Domestic Product
GFC	Global Financial Crisis
GNI	Gross National Income
IMF	International Monetary Fund
LMIC	Low- and Middle-Income Countries
MSMEs	Micro, Small and Medium sized Enterprises
MYR	Malaysian Ringgit

Executive Summary

Introduction

This report, commissioned by the Donor Committee for Enterprise Development's Business Environment Reform Working Group, considers how lower and middle-income countries can respond to acute exogenous economic shocks through business environment reforms. The report focuses on reforms for micro, small and medium sized enterprises, and considers the experience of Brazil, Egypt, Ethiopia and Malaysia in answering the research questions. A policy brief is also available, summarizing the key findings of this report.

The vulnerability of smaller firms originates from a complex set of, often self-reinforcing, reasons. Further, the heterogeneity of micro, small and medium enterprises, requires government support to be tailored to the needs of different segments of enterprises. Among these, are informal businesses. These businesses are creating jobs, but these are precarious jobs without the safety of social security systems or labour regulations.

What Determines Macro Economic Resilience?

Several indicators of capability to respond to shocks and stresses exist. Their adoption by policy makers has been confounded by the complexity and dynamism of the mechanisms under consideration, data availability and the heterogeneity of economies, businesses and shocks. This paper investigates macroeconomic resilience as comprising of two dimensions:

1. The capacity to withstand the immediate impact of an adverse economic exogenous shock:
    - External financing needs;
    - External solvency;
2. The capacity to promptly respond to the effect of an adverse economic exogenous shock;
    - Fiscal balance as a ratio of gross domestic product;
    - Government indebtedness;
    - Deviation of inflation from target; and,
    - Institutional and regulatory quality (as a proxy for the business environment).

The four case study countries have varying scores in this resilience indicator. This is displayed in Table 1. Only Malaysia scored positively on the scale of -1 to 1. Ethiopia scored lowest of case study countries.

Table 1: Resilience indicators in 2019[1]

Brazil	Egypt	Ethiopia	Malaysia
- 0.27	- 0.46	- 0.84	0.33

[1] Rojas Suares, L, 2023, Identifying macroeconomic resilience to external shocks in emerging and developing economies, Centre for Global Development, https://www.cgdev.org/publication/identifying-macroeconomic-resilience-external-shocks-emerging-and-developing-countries

The adoption of effective counter cyclical policies to respond to shocks, is constrained by policy space. This constraints resilience. The debt position, particularly short-term external debt, has deteriorated in many low- and middle-income countries. These positions are now out of balance with balance of payments positions, and forecasted growth rates. Funds that could be used to finance the Sustainable Development Goals, build resilience and respond to shocks, are increasingly directed to financing debt.

Regulatory quality also constrains the effectiveness of the policy response in low- and middle-income countries. There is a need for regulations to be more cognisant of the needs of micro, small and medium enterprises, and for macroeconomic managers to be guardians of both economic stability and inclusive development. Across case study countries progress to improve regulatory quality is slow and seems to reverse between acute crises. There is a need to maintain improvements in regulatory quality.

With exogenous shocks expected to increase in incidence and severity, concerted action must now be taken to increase resilience. This is particularly pressing given multiple concurrent threats.

Which Business Reforms Respond Well to Acute Global Shocks?

Correlation between measures and impacts, during the COVID-19 pandemic, has been partly determined across low- and middle-income countries. Causation has not been determined. Monetary transfers and access to credit, which relax short term credit and liquidity constraints, are correlated with higher future expected sales growth. Wage subsidies are negatively correlated with laying off workers, but these do not affect expected future sales growth. Tax support, meanwhile, is positively correlated with future expected sales growth, but does not influence the likelihood of falling into arrears nor reducing the likelihood of insolvency. Payment deferrals of tax, seems to be the least effective policy. [2]

The effectiveness of measures directly supporting micro, small and medium enterprises, is driven by how they are relevant to the needs of these businesses. Business Pulse Surveys demonstrate that the demand for policy support differed across country income groups, firm size, formality status, exporting status and transmission channels. Half of all businesses in surveyed countries demanded access to finance measures (e.g. deferral of credit payments, suspension of interest payments, rollover of debt, new credit and loans with subsidised rates) and tax reductions and deferral measures.[3] Tax reductions and deferrals were more in demand in low-income countries, but also less possible because of fiscal space. Monetary transfers, payment deferrals and access to credit were in more demand in middle income countries. There was a particular mismatch between the needs of businesses, and support provided, in payment deferrals and access to credit.

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[2] Xavier, C, 2021, Policies to support businesses through the COVID 19 shock: A firm level perspective, online, available at: https://documents1.worldbank.org/curated/en/188461610547807479/pdf/Policies-to-Support-Businesses-through-the-COVID-19-Shock-A-Firm-Level-Perspective.pdf

[3] Cirera, X, et al, 2021, Policies to support businesses through the COVID-19 shock, online, available at: https://documents1.worldbank.org/curated/en/188461610547807479/pdf/Policies-to-Support-Businesses-through-the-COVID-19-Shock-A-Firm-Level-Perspective.pdf

Debt finance interventions were deployed in all case study countries. They were more in demand in middle income countries, where financial access is more prevalent.[4] Malaysia deployed the greatest number of debt finance interventions, followed by Brazil. Ethiopia, with constrained policy space, deployed one measure.

+ Debt finance is most relevant during short term demand shocks, and only for formal businesses.
+ Debt financing will be more effective where firms have ready access to finance.
+ Debt finance allows for the self-selection of firms or behaviours with desirable characteristics, such as viability- where loans are appropriately assessed.[5]
- Debt finance measures would not be available for informal businesses, nor those facing challenges in accessing finance.
- Data is often not available to assess solvency nor future viability, challenging targeting.[6].
- Rapid increases in interest rates, post-acute shocks, results in burdens to Micro, Small and Medium Enterprises.
- Guarantee schemes may deliver longer term budgetary costs.

Employment support measures were more in demand in middle income countries, than low-income countries.

+ Wage subsidies could only be directed towards formal businesses, with registered workers.
+ Wage subsidies are most relevant to short term demand shocks, and natural resource shocks.
+ Wage subsidies are in particular demand in middle income countries, where informality is lower.
+ Wage subsidies can be particularly effective during economic recovery, to tilt the incentives of firms towards restarting.[7]
- Wage subsidies would not reach informal enterprises, nor their entrepreneurs or workers. Social safety nets must be expanded effectively, vertically and horizontally, to provide support to these workers.
- Wage subsidies, used in isolation, can encourage employment retention, at the expense of the efficient reallocation of labour.

Social safety nets were reformed to support informal workers during the COVID-19 pandemic. The effectiveness of these reforms was challenged by the availability of finance to scale up support, and the uniqueness of the stresses. The case load affected by COVID-19 pandemic was different than the case load affected by other shocks. Preparatory steps should be taken to enable the rapid and effective adaptation of social safety nets.

All countries deployed tax measures. Tax measures were particularly in demand in lower income countries, where access to finance is limited. Tax measures were less likely to be deployed in these countries,

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[4] Cirera, X, et al, 2021, Policies to support businesses through the COVID-19 shock, online, available at: https://documents1.worldbank.org/curated/en/188461610547807479/pdf/Policies-to-Support-Businesses-through-the-COVID-19-Shock-A-Firm-Level-Perspective.pdf

[5] World Bank, Crisis and recovery: Learning from COVID 19's impacts and policy responses in East Asia, online, available at: https://www.worldbank.org/en/events/2023/07/11/crisis-and-recovery-learning-from-covid-19-s-economic-impact-and-policy-responses-in-east-asia-report-launch

[6] World Bank, 2021, Supporting firms in restructuring and recovery, online, available at: https://documents1.worldbank.org/curated/en/306401616131450724/pdf/Supporting-Firms-in-Restructuring-and-Recovery.pdf

[7] Blanchard, O, 2020, A new policy toolkit is needed as countries exit COVID lockdown, Petersen Institute for International Economic Policy Brief no. 20-8

however.[8] Ethiopia deployed tax measures, that were limited in scope. Tax measures could not reach those unregistered for tax.

- + Tax measures are most relevant to short term demand shocks and natural disasters and can assist with managing liquidity in formal firms.
- + Tax measures can use financial information to target tax relief.
- + Tax relief measures can be rapidly designed and deployed.
- + Tax based measures can allow for an immediate response, while better enabling building back better through incentivising investment and innovation.
- - Tax measures will not reach informal Micro, Small and Medium Enterprises.
- - Corporate tax deferrals only assist those firms that make a profit,
- - The common requirement for two years' worth of past information reduces the efficiency of this measure, as solvency and viability changes rapidly during crises.

No case study countries supported business entry, hibernation or exit reforms. These measures do provide opportunity for countries with limited monetary or fiscal policy space, to enable business dynamism during shocks thereby furthering structural change. Extraordinary time bound adjustments to insolvency frameworks, can stop viable firms being pushed into bankruptcy. Designing and implementing regulations that allow micro, small and medium enterprises hibernation, will also further resilience. Despite this opportunity, during the pandemic, regulatory flexibility in low- and middle-income countries centred on trade related regulations. This aimed to secure cross border value chains and reduce demand and supply stresses. Reduced customs duties were most prevalent, followed by streamlined customs procedures and the elimination of import licensing.[9]

Which Institutional Conditions Favour Resilience?

Governments face tough choices when economic crises eventuate. This challenge is often worsened by political divisions, insecurity, and social unrest.

Regulatory quality captures of perceptions of the ability of authorities to formulate and implement sound private sector policies. Only Malaysia shows gradual improvements in regulatory quality, between the Global Financial Crisis to now. Estimations of regulatory quality for Brazil, Egypt and Ethiopia all worsened during normal business cycles between the Global Financial Crisis and the onset of the COVID 19 pandemic. They then improved slightly during the COVID-19 pandemic. Regulatory quality seems deteriorate during normal business cycles and improves during acute exogenous shocks.

The risks of unequal state business relations have been born out in past crises. Across East Asia, strong business government relations contributed to fast growth rates before the Asian Financial Crisis. But these imbalances contributed to the crisis Asian Financial Crisis. During the COVID 19 pandemic, state owned, and strategic businesses, are more likely to receive support- to the detriment of micro, small and medium enterprises. Egypt's system for state business relations has created influential state-owned enterprises.

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[8] Cirera, X, et al, 2021, Policies to support businesses through the COVID-19 shock, online, available at: https://documents1.worldbank.org/curated/en/188461610547807479/pdf/Policies-to-Support-Businesses-through-the-COVID-19-Shock-A-Firm-Level-Perspective.pdf

[9] OECD, 2023, Regulatory flexibility, online, available at: https://www.oecd.org/trade/resilient-supply-chains/regulatory-flexibility/#:~:text=Regulatory%20flexibility%20does%20not%20mean,or%20services%20can%20be%20accelerated.

The effectiveness of government industry relations matters. In Ethiopia, government industry relations differ within industries have influenced policy outcomes unevenly.[10] Trust and collective learning have been established in floriculture, surrounding logistical privileges. However, in leather, path dependency and internal fragmentation have undermined collective learning.

Governments face challenges in coordinating their actions. Enhanced coordination among agencies is instrumental to the provision of efficient and effective support. However, case study countries used existing coordination mechanisms during the COVID 19 pandemic. Coordination bodies should be inclusive of micro, small and medium enterprises, and their representative organisations. Experience from case study countries, suggests that greater emphasis should be given to communicating the support available to smaller businesses. Coordination mechanisms should also design mechanisms to ensure that support is accessible to smaller businesses.

Public private and social dialogue can lift the profile of the needs of the specific needs of different segments of micro, small and medium enterprises. There is a need, across economies, for Government to involve civil society, the private sector and local actors to increase transparency in decision making, as well as the relevance, efficiency and effectiveness of support.[11] This is especially pressing when rapidly designing and deploying measures to support businesses during shocks.

What Data, At Macro and Firm Level, Can Evidence Resilience?

Resilience remains inconsistently theorised. Achieving consistency in theory is confounded by the heterogeneity of shocks and contexts. This hampers the widespread adoption of a resilience indicator. During the Global Financial Crisis, a resilience indicator was formulated that aimed to measure the effect of shock absorption and shock counteraction policies.[12] This included measures of i) macroeconomic stability, ii) micro economic market efficiency, iii) good governance and iv) social development. This was updated in 2016 to account for the increasing relevance of environmental governance and increased exposure of the real sector to financial markets instability, among others.

Another composite indicator attempts to capture vulnerability to disasters, and macro and micro economic resilience. The latter was captured at the household level, to account for welfare changes.[13] Household level data could be replaced with data capturing the resilience of micro, small and medium enterprises. Innovations in the measurement of economic resilience continue. An innovation in upper income countries, reduces the emphasis on fiscal and monetary policy space and increases emphasis on investment in research and development, the contribution of services to gross domestic product and social progress, among others.[14]

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[10] Oqubay, A, 2018, Industrial policy and late industrialisation in Ethiopia, African Development Bank, Working Paper no. 303
[11] OECD, 2022, First lessons from government evaluations of COVI9 responses: A synthesis, online, available at: https://read.oecd-ilibrary.org/view/?ref=1125_1125436-7j5hea8nk4&title=First-lessons-from-government-evaluations-of-COVID-19-responses
[12] Briguglio, L, et al, 2009, Economic vulnerability and resilience: Concepts and measures, UNU WIDER, https://www.wider.unu.edu/publication/economic-vulnerability-and-resilience-0
[13] Hallegate, S, 2014, Economic resilience: Definitions and measurement, online, available at: https://documents1.worldbank.org/curated/en/350411468149663792/pdf/WPS6852.pdf
[14] EC, 2023, Economic Resilience Indicator, online, available at: https://composite-indicators.jrc.ec.europa.eu/explorer/explorer/indices/eri/economic-resilience-index

Information asymmetries between firms and policymakers are extremely pervasive. To measure resilience as an outcome and target support, it would be necessary to track firms over time. This will allow for the identification of firms that were able to recover from disruptions. International organisations have not yet embarked on a global effort to build a resilience index for businesses in Low- and Middle-Income Countries, although empirical work has begun. Accenture has developed a resilience index for multinational companies.[15]

The timeliness of data matters, as does the assessment of future viability. Despite the attraction of debt finance to policy makers, assessing solvency and viability is extremely challenging during a shock.[16] Viability can be determined by establishing if the discounted value exceeds the recovery value of assets through forced sale. This data is often not available, especially for smaller businesses.

When considering data to target firms, authorities could consider utilising (in declining order of capability requirements):

- Solvency measures- where the discounted value exceeds obligations to banks and government;
    - As this changes during crises, government arrears should be cleared to allow for insolvency to be determined;
- Vulnerability- Declines in revenue have been used to identify vulnerable firms;
    - This can be complemented with a notion of solvency to avoid channelling funds to firms who do not need support or who are unlikely to survive anyway;
- The segmentation of firms, as exporters, young firms and start-ups may experience acute financial distress while being particularly important for the recovery;
    - At minimum these firms should be identified early, and should not be excluded from support programmes.
- Size/informal status- There is less rationale in using public funds to support informal firms where entry and exist costs are lower, and intangible capital rests with the entrepreneur;
    - Identifying a cut-off point relating to size can allow social security systems to support informal micro and small businesses.

[15] Accenture, 2023, Reinventing for resilience: A CEO's guide to achieving long term profitable growth, online, available at: https://www.accenture.com/content/dam/accenture/final/accenture-com/document/Accenture-Reinventing-for-Resilience-CEO-Guide.pdf#zoom=40

[16]Supporting firms in restructuring and recovery, online, available at: https://thedocs.worldbank.org/en/doc/109351615592343952-0130022021/original/FirmsNote2.0FINAL031221.pdf

1. Purpose, structure and methodology

1.1 Purpose and structure

How can lower and middle-income countries (LMIC) prepare and respond to shocks through business environment reforms? What can donors do to support this? This report, commissioned by the Donor Committee for Enterprise Development's (DCED) Business Environment Reform Working Group, addresses these questions. It does this through analysing the cases of economies that have (or have not) demonstrated resilience in the face of global shocks. The report contributes to a broader stream of research conducted through the DCED, directed towards supporting resilience in LMIC.[17]

Four research questions are addressed in this Technical Report, with a focus on micro, small and medium sized enterprises (MSMEs) in LMIC.

1. What factors contribute to an economy's ability to respond to shocks and stresses and adapt to new opportunities and threats?
2. Which business and investment climate reforms targeted at MSMEs have effectively responded to global shocks, and which ones have not? Why is this the case?
3. Under which (legal, regulatory and institutional framework) conditions can business and investment climate reforms aimed at resilience be successfully implemented at the macroeconomic level?
4. What types of data indicating firm and economic performance may be used as evidence for resilience? What possible explanatory factors may account for the patterns detected?

There are two audiences for this study. These are:

1. Governments of LMIC– to give an overview of the best policies and instruments available; and,
2. Development partners – to consider their policy advice.

Following this opening section, Section 2 defines vulnerability, resilience and shocks, and categorises exogenous shocks in LMIC. The four research questions are then considered in sequence. Recommendations are made in each section; the final section concludes and summarises the recommendations of the report.

1.2 Methodology and limitations

The research questions are considered in relation to four LMIC: Brazil, Egypt, Ethiopia and Malaysia. This consideration included a review of the literature. Interviews were expected to be held with donors, authorities and business membership organisations. Interviews were limited in scope and focused on donor agencies, because of challenges in arranging interviews. Where they occurred, they sensed checked the findings and emerging recommendations.

[17] DCED, 2023, Overview of the Business Environment Reform Working Group, online, available at: https://www.enterprise-development.org/organisational-structure/working-groups/overview-of-the-business-environment-working-group/

The report has sought to strike a balance between the depth and breadth of coverage, given the broad scope of the assignment and resources available. Choices have therefore been made on what to focus on. Key choices, and the approach adopted, are detailed below.

- LMIC are subject to a range of shocks. The COVID 19 shock induced supply and demand stresses and has attracted the focus of authors across countries. Because of this, and its recency and impact, this is a focus of this paper. A range of other shocks are also relevant and are considered. Supply and demand stresses are hence introduced in Section 2, and the relevance of measures to these shocks considered in Section 4. Meanwhile, Section 3 focuses on changes to the determinants of macroeconomic resilience between the Global Financial Crisis and the COVID 19 pandemic.
- The literature review did not identify any secondary evidence that identified the effectiveness of business environment reform responses in LMIC. It was therefore not possible to make robust judgements on which business environment reforms work. The reasons for this are further elaborated in Section 4. This section therefore focuses on drivers of relevance and efficiency. Focus is also given to the most implemented business environment reform measures across LMIC. Light consideration is given to social safety nets, which have relevance to informal entrepreneurs and their workers.

1.3 Case study countries

Table 2: Characteristics of case study countries

	Brazil	Egypt	Ethiopia	Malaysia
Population, 2022[18]	215.3 m	110.9 m	123.4 m	33.9 m
GNI/capita (Atlas, US$), 2022[19]	8,140	4,100	1,020	11,380
Regulatory quality[20]**, 2022**[21]	49	25	17	73l
General government gross debt (% of Gross Domestic Product), 2024[22]	90%	88%	31%	67%

[18] World Bank, 2024, World Development Indicators, online, available at: https://databank.worldbank.org/source/world-development-indicators

[19] World Bank, 2024, World Development Indicators, online, available at: https://databank.worldbank.org/source/world-development-indicators

[20] Regulatory quality covers perceptions of the ability of the Government to formulate and implement sound policies and regulations that permit and promote private sector development.

[21] Kaufmann, D and A Kraay, 2023, Worldwide Governance Indicators, online, available at: www.govindicators.org

[22] IMF, 2024, General Government Gross Debt as a % of GDP, online, available at: https://www.imf.org/external/datamapper/GGXWDG_NGDP@WEO/OEMDC/ADVEC/WEOWORLD

LMIC demonstrate considerable heterogeneity. For the 2024 fiscal year, LMIC are identified by having levels of Gross National Income (GNI) per capita of less than US$ 13, 845 per annum. [23] 135 countries comprise this grouping, that can be segmented further by GNI, but also endogenous criterion such as level of indebtedness and regulatory quality.

Case study countries achieve geographical representation and cover larger LMIC. Identified case study countries provide representation from Latin America and the Caribbean, sub–Saharan Africa, the Middle East and North Africa and Asia. They cover larger economies, but not small island economies, though note that Section 3 finds that some small island economies demonstrate high levels of policy induced resilience. The selection of case studies also covers a range of scores in fiscal space and regulatory quality. This is necessary, as policy space and regulatory quality are important determinants of capability to prepare and respond to shocks in LMIC. Key characteristics of case study countries are included in Table 2.

1.1.1 MSMEs in Brazil

Brazil currently demonstrates a moderate level of resilience, among LMIC. The COVID 19 pandemic and the global financial crisis, and associated downturns, have halted progress in poverty reduction in Brazil.[24] Small and micro enterprises play a fundamental role in the economy, accounting for half of all formal employment. However, two fifths of all employees are employed informally.

Brazil was deeply impacted by the pandemic. This was the result of a slow and ineffective response to the pandemic, contributed to by ineffective leadership, and existing inequalities. GDP fell by 3.3% during 2020, this was driven by declines in GDP in services.[25] Micro and small enterprises, measured by employment, were more exposed to the COVID 19 pandemic, as they had lower financial capability.[26] 19% of employees in the informal sector, and 7% of employees in the formal sector, lost their jobs between 2019 and 2020. Laid off workers tended to withdraw from the labour market, rather than registering as unemployed or starting informal businesses, during the COVID 19.[27] In recent shocks, the informal sector has not been playing its expected counter cyclical role. By the last quarter of 2021, the labour market had returned to its pre-crisis levels, with the same number of (formal and informal) employed, and unemployed.

1.1.2 MSMEs in Egypt

Egypt currently demonstrates a moderate level of resilience, among LMIC. Egypt's economy has been negatively affected by political instability since 2011, and structural internal and external imbalances make the economy vulnerable to exogenous shocks.[28] MSMEs account for 98% of Egypt's enterprises, and 85% of non-agricultural private sector employment. These enterprises have been the primary absorber of labour force entrants, albeit mostly in the informal sector. Despite its apparent vulnerability to shocks, Egypt was one of the few LMIC that did not experience negative GDP growth rates during the COVID 19 pandemic. This

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[23] World Bank, 2024, World Bank Country and Lending Groups, online, available at: https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups
[24] World Bank, 2022, Brazil Poverty and Equity Assessment: Looking Ahead of Two Crises, online, available at: https://openknowledge.worldbank.org/server/api/core/bitstreams/19298bfa-067d-504c-8e34-00b20e3139d2/content
[25] Agencia IBGE, Economic statistics, online, available at: https://agenciadenoticias.ibge.gov.br/en/agencia-news/2184-news-agency/news/35375-with-services-affected-by-pandemic-gdp-of-2020-falls-3-3
[26] World Bank, 2020, COVID 19 in Brazil: Impacts and Policy Responses, online, available at: https://documents1.worldbank.org/curated/en/152381594359001244/pdf/Main-Report.pdf
[27] Razafindrakoto, M, et al, 2023, Crises, Labour Market and Informality in Brazil: The COVID-19 Shock in the Light of Past Dynamics, Third World Quarterly, online, available at: https://www.tandfonline.com/doi/epdf/10.1080/01436597.2023.2243834?needAccess=true
[28] Zakir, C, 2017, An overview of structural imbalances in Egypt, online, available at: https://journals.openedition.org/ema/3727?lang=en

was partly as wide scale movement control orders were avoided, and as there was a timely response from Government.[29] These factors bolstered resilience.

75% of MSMEs suffered from a decline in their operations, and 9% ceased trading. There was a 15% decrease in employment in MSMEs. MSMEs were hardest hit by lower sales and orders, and increases in costs due to higher energy prices.[30] The share of Egyptians in employment fell by 8% between February and June 2020, and this drop was sharper among females than males. Two thirds of informally employed wage workers and self-employed workers suffered wage losses.[31]

1.1.3 MSMEs in Ethiopia

Ethiopia currently demonstrates low levels of economic resilience, among LMIC. Ethiopia is the second most populous country in Africa. It is also one of the fastest growing LMIC economies. However it remains one of the poorest. With 600,000 entering the labour market each year, MSMEs provide opportunity to labour force entrants. MSMEs created 880,000 new jobs between 2018 and 2019, despite Ethiopia having the lowest entrepreneurial rates in Africa.[32] Partly, these entrepreneurial rates are a symptom of Government favouring larger businesses. COVID 19 severely effected economic activity, remittances dropped by 10% and external demand collapsed.[33] Ethiopia continued to implement its Homegrown Economic Reform Agenda despite the pandemic, and these reforms supported continued GDP growth. However, 8% of workers lost their jobs. The self-employed and casual workers were particularly affected.[34] Employment rates rebounded to pre-crisis levels in rural areas during 2020, but this took longer in urban areas.

1.1.4 MSMEs in Malaysia

Malaysia demonstrates high levels of economic resilience, among LMIC. Malaysia has developed rapidly, with GNI per capita growing at an average annual rate of 7% between 1960 and 2017.[35] Less than 1% of the population live below the US$1.90 poverty line. There are 1.2 million MSMEs in Malaysia, which contribute 38% of GDP, 48% of employment, but only 11% of exports.[36] Informal employment stands at 8.6% of total employment, which is below other countries in the region. MSME are concentrated in the services sector. These businesses were disproportionately impacted by the COVID 19 pandemic, given their contact intensiveness and Movement Control Orders. During the COVID 19 pandemic, 56% of MSMEs reported that they were operating as usual, with 37% running with reduced operations and 6% closing temporarily. MSME GDP growth was -7.3% in 2020. However, this rebounded to 1% in 2021. 7.3 million people were employed in MSMEs in 2021.[37]

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[29] IMF, 2021, Egypt: Overcoming the COVID Shock and Maintaining Growth, IMF Country Focus, online, available at: https://www.imf.org/en/News/Articles/2021/07/14/na070621-egypt-overcoming-the-covid-shock-and-maintaining-growth

[30] MOPED, 2021, Egypt's planning Ministry reveals survey results over impact of pandemic on MSME, online, available at: https://mped.gov.eg/singlenews?id=554&type=next&lang=en

[31] ILO, 2021, The Impact of COVID 19 on Employment and Wages in Egypt, online, available at: https://www.ilo.org/sites/default/files/wcmsp5/groups/public/@africa/@ro-abidjan/@sro-cairo/documents/publication/wcms_791076.pdf

[32] Job Creation Commission Ethiopia, 2021, Job Creation Through Off Grid Energy Access, online, available at: https://www.ace-taf.org/wp-content/uploads/2021/08/Jobs-and-Energy-Report_Ethiopia-_August_2021.pdf

[33] World Bank, 2021, Ethiopia Economic Update, online. Available at: https://openknowledge.worldbank.org/entities/publication/ad8e253a-801c-5e55-a5e7-464139b4c820

[34] UNCTAD, 2022, Ethiopia's Response to the COVID 19 Pandemic: Measures, Impacts and Lessons. Online. available at: https://unctad.org/system/files/official-document/BRI-Project_RP25_en.pdf

[35] World Bank, 2024, The World Bank in Malaysia, online, available at: https://www.worldbank.org/en/country/malaysia/overview

[36] UNDP, 2022, Building MSME Resilience in Southeast Asia: With a Country Focus on Thailand and Malaysia, online, available at: https://www.sme-enterprize.com/wp-content/uploads/2024/03/Building-MSME-Resilience-in-Southeast-Asia.pdf

[37] UNDP, 2023, Ecosystem for Effective Solutions to Support MSME's COVID 19 Recovery and Resilience: The Malaysian Experience, online, available at: https://www.undp.org/malaysia/publications/ecosystem-effective-solutions-support-msmes-covid-19-recovery-resilience-malaysian-experience

2. Defining and segmenting shocks

2.1 Defining and segmenting shocks

Exogenous shocks are unpredictable or unexpected sudden event not initiated by a given, market, community or country, that has a significant negative macro-economic negative impact on that country.[38] These shocks, as bad events of all kinds, can be distinguished along two dimensions:

1. Exogeneity (the extent to which it emanates from outside LMIC and is anthropogenic); and,
2. Acuteness (as opposed to being chronic).

LMIC are vulnerable to a wide range of acute exogenous shocks, and they are less resilient. [39] Each shock is different. It is therefore challenging to categorise types of shocks definitively across the two dimensions.

Global financial crises and overarching climate change impacts can be more exogenous to LMIC than higher income countries. For financial crises, this is because global financial shocks have arisen mostly from outside LMIC, and higher income countries are more influential in determining how the international financial system operates and the capability of their own preparedness and responses. This capability could limit or exacerbate the depth, breadth and length of stresses that impact LMIC. Meanwhile, some global shocks have emanated from LMIC themselves. These have been exogenous shocks to non-source LMIC. The COVID 19 pandemic is one such example, which emanated from China. Meanwhile, a war between Russia and Ukraine, two middle income countries in 2022, imparted stresses on LMIC besides Russia and Ukraine.

Shocks overlap and interact, leading to complex stresses. Some categories of shocks may increase in frequency and impact, such as cyber security attacks and climate related weather events.[40] Shocks often interact with each other, for example input prices rose as demand recovered from the COVID 19 pandemic, and as war started in Ukraine. Further, scars from shocks, such as constrained fiscal space and high debt burdens among MSME, can lower resilience in managing new shocks.

2.2 Segmenting stresses

Stresses are the crises that the primitive exogenous shock places on a business ecosystem. Most simply, these emanate from supply induced or demand induced stresses, either of which can lead to messy stresses. For example, Keynesian stresses are defined by stresses to supply, causing changes in aggregate

[38] Miklian, J and K Hoelscher, 2021, SMEs and Exogenous Shocks: A Conceptual Literature Review and Forward Research Agenda, International Small Business Journal, online, available at: https://journals.sagepub.com/doi/10.1177/02662426211050796
[39] OECD, 2021, Fostering economic resilience in a world of open and integrated markets: Risks, vulnerabilities and areas for policy action, online, available at: https://www.oecd.org/newsroom/OECD-G7-Report-Fostering-Economic-Resilience-in-a-World-of-Open-and-Integrated-Markets.pdf
[40] ILO, 2021, A framework to support small firms in developing countries navigate crises and build resilience, online, Available at: https://www.ilo.org/publications/framework-support-small-firms-developing-countries-navigate-crises-and

demand larger than the shock themselves.[41] The recent COVID 19 pandemic exhibited this characteristic, in some countries. Stresses, from events, often overlap.

Stresses can be common across certain exogenous shocks. This commonality is displayed in Figure 1 and is continued in the consideration of the relevance of measures in Section 4. Commonality arises from shocks having similar channels of causation. For example, war in other countries (e.g. attacks on shipping) and climate related weather events (in other countries)- will both impact LMIC firstly through supply stresses, that results in the higher costs of inputs. Meanwhile, the GFC was considered a demand stress in many low LMIC through its impact on remittances, exports and foreign direct investment inflows. Although, those LMIC more closely integrated into global financial markets did suffer from financial contagion, which resulted in constraining the supply of financial services.[42]

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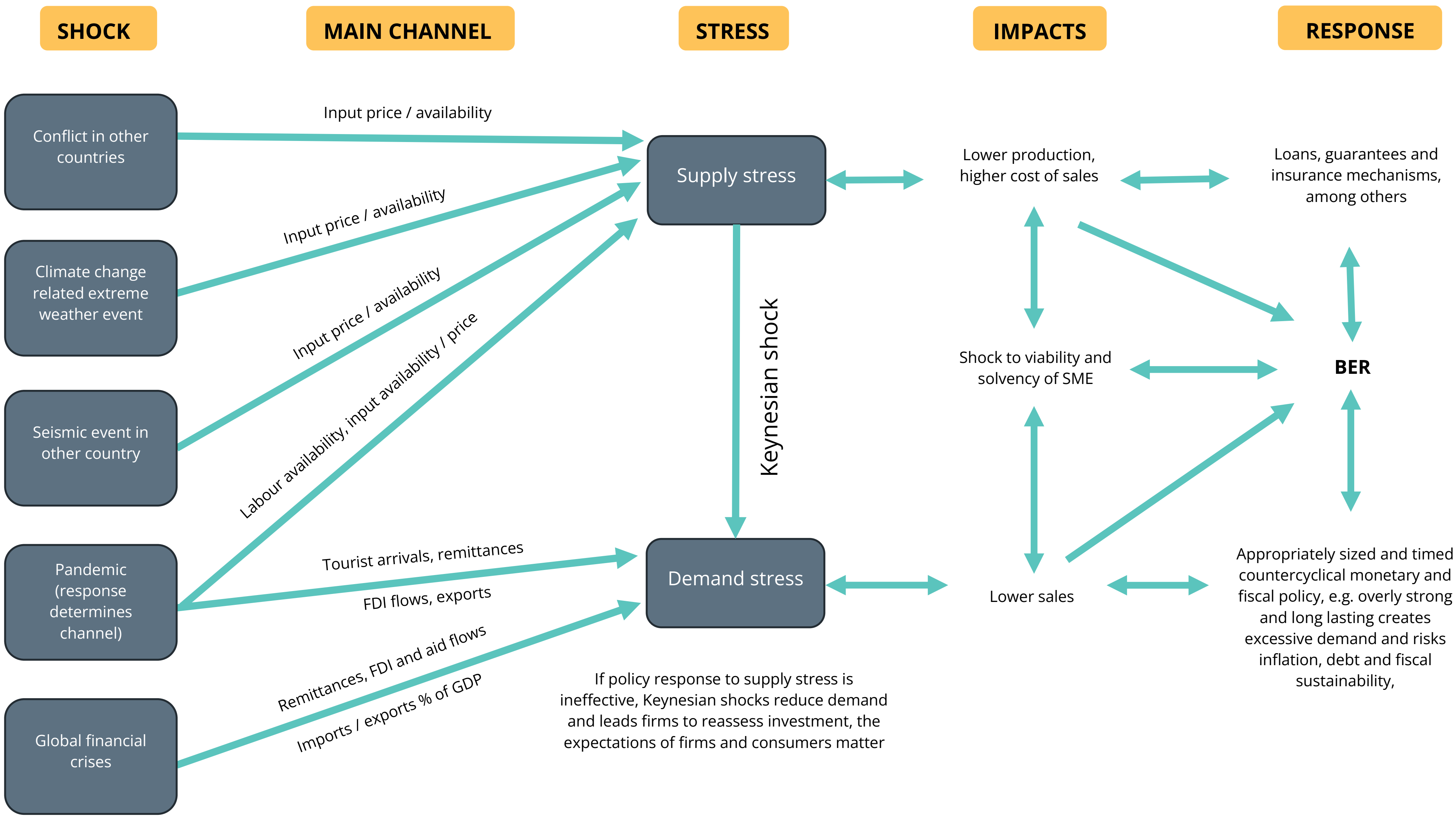
[41] Guerrieri, V, G Lorenzoni, L Straub and I Werning, Macroeconomic Implications of COVID 19: Can Negative Supply Shocks Cause Demand Shortages, NBER Working Paper: 26918, online, available at: https://www.nber.org/papers/w26918
[42] Ozkan, F and D, Unzal, 2012, Global financial crises, financial contagion and emerging markets, IMF Working Paper, online, available at: https://www.imf.org/external/pubs/ft/wp/2012/wp12293.pdf

Figure 1: From primitive exogenous events to stresses, impacts on MSME and responses, Author's elaboration

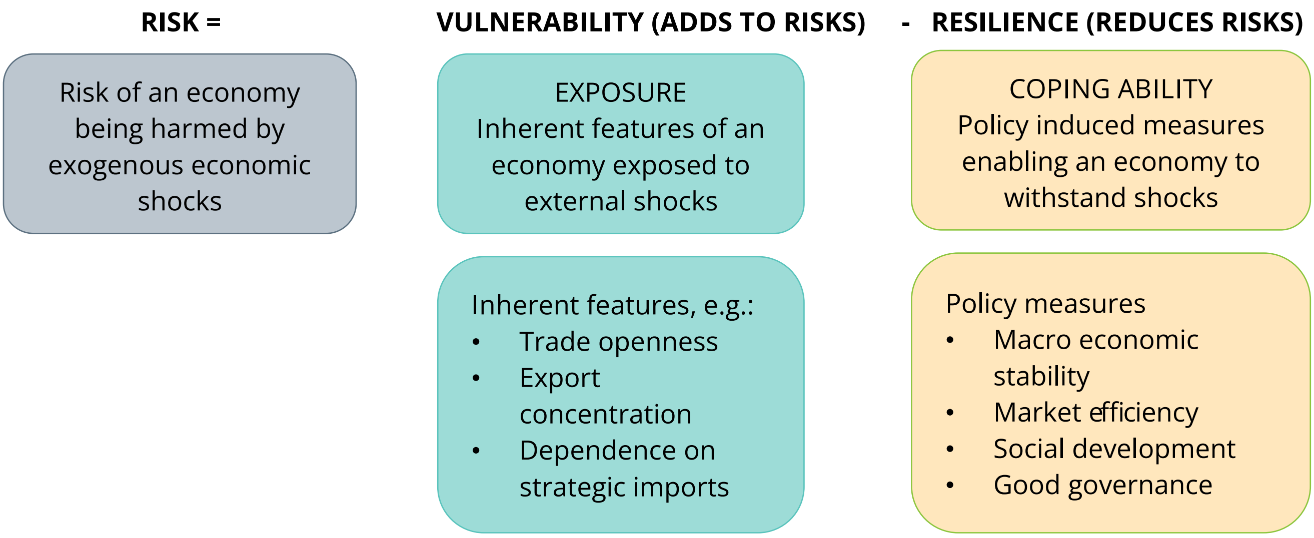


2.3 Vulnerability and resilience

Vulnerability and resilience are juxtaposed.[43] Risks of harm by exogenous shocks increases with vulnerability and decreases with resilience. Drivers of macroeconomic vulnerability include exposure, which adds to risks, and depends on trade openness, export concentration and dependence on strategic imports, among others. Resilience determines coping ability, which is driven by the effectiveness of policies. This framework is displayed in Figure 2.

Despite its focus by donor agencies,[44] **resilience remains inconsistently theorised**.[45] For this study, economic resilience has two components, i) the ability to limit immediate production losses and social costs and ii) the ability to reconstruct and recover.[46] Governments in LMIC face choices in preparing for and responding to shocks. Fiscal, monetary, prudential and business environment reforms are available to be deployed. [47] However, policy space is severely constrained in some LMIC, because of recurrent stresses, long term imbalances (e.g. revenue and short-term debt to GDP) and the result of structural adjustment policies. In these cases, more focus could be given to improvements in the business environment (such as institutional mechanisms, regulatory quality and business hibernation reforms) before and during crises, while addressing imbalances as a longer-term objective.

Figure 2: Risk of harm by external exogenous shocks[48]



[43] Khor, E at al, 2016, Building Resilience in the Pacific Island Countries, Ch. 2 in Resilience and Growth in the Small States of the Pacific, online, available at: https://www.elibrary.imf.org/display/book/9781513507521/ch003.xml?tabs=fulltext
[44] World Bank, Crisis response and resilience to systemic shocks: What works, https://ieg.worldbankgroup.org/sites/default/files/Data/reports/building-resilience.pdf
[45] Barrett, C et al, 2021, A scoping review of the development resilience literature, theory, methods and evidence, World Development, https://www.sciencedirect.com/science/article/abs/pii/S0305750X21002278
[46] Hallegate, S, 2014, Economic resilience: Definition and measurement, World Bank Policy Research Working Paper, no. 6,852, online, available at: https://documents1.worldbank.org/curated/en/350411468149663792/pdf/WPS6852.pdf
[47] ILO, 2021, A framework to support small firms in developing countries navigate the crisis and build resilience, online, available at: https://www.ilo.org/global/publications/working-papers/WCMS_831842/lang--en/index.htm
[48] Briguglio, L. 2008, Economic Vulnerability and Resilience Concepts and Measures,WIDER Research Paper online, available at: https://www.econstor.eu/bitstream/10419/45146/1/571437761.pdf

2.4 Shocks, stresses and firm characteristics

Regardless of the type of exogenous shock, economic disruption occurs to the macro-economic environment, and individual businesses and the sectors they operate in.[49] Shocks, and their stresses create uncertainty and ambiguity. Studies have identified how i) dynamics of firm size, ii) the capacity, agency and nature of crises response and management and iii) the rationality of decision making, as determinants of how individual businesses are affected. This report focuses on the responses to smaller businesses, as:

- Firm size correlates with the ability to survive shocks; and,
- Smaller businesses differ intrinsically in their ability to survive shocks.[50]

The vulnerability of smaller firms originates from a complex set of, often self-reinforcing, reasons. Alongside government and regulatory challenges, these include:

- Insufficient financial development;
- Market access;
- Negotiation ability;
- Business practices;
- Productivity;
- Skills and capability; and,
- Workforce vulnerability.[51]

While less resilient, smaller businesses also demonstrate much higher levels of agility.[52] This agility builds resilience. In low- and middle-income countries. Informal coping strategies are often not chosen but are imposed by the absence or insufficiency of formal regulations to guarantee the survival of business.[53]

The heterogeneity of MSMEs, requires Government support to be tailored to the needs of different segments of MSMEs. Among these is informality. The informal economy represents 35% of GDP across LMIC.[54] Micro enterprises are most likely to be informal, or quasi registered. The informal economy is marked by acute decent work deficits, and 85% of all informal workers are in precarious employment. Informal businesses are particularly at risks during shocks, as they tend to have lower financial buffers and are less able to access policy support measures. Further, workers, and owners, of informal businesses are usually unable to access social security benefits associated with their employment.

The gender of entrepreneurs, and workers, also matters for the resilience of businesses. There are significant gender disparities in business cycles, across unemployment, income risk and hours worked.[55]

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[49] Hudeceheck, M, 2020, How companies can respond to the coronavirus, MIT Sloan Management Review, online, available at: https://sloanreview.mit.edu/article/how-companies-can-respond-tothe-coronavirus/
[50] Miklian, J and K Hoelscher, 2021, SMEs and exogenous shocks: A conceptual literature review and forward research agenda, online, available at: International Small Business Journal, vol. 40, no. 2
[51] ILO, 2023, A framework to support small firms in developing countries navigate crises and build resilience, online, Available at: https://www.ilo.org/publications/framework-support-small-firms-developing-countries-navigate-crises-and
[52] WEF, 2022, The big opportunity behind small business, online, available at: https://www.weforum.org/stories/2022/12/future-readiness-here-s-why-smaller-businesses-success-matters/
[53] ESCAP, 2024, Improving MSME resilience and agility, online, available at: https://msmepolicy.unescap.org/improving-msme-resilience-and-agility
[54] IMF, 2021, Five Things to Know About the Informal Sector, IMF Country Focus, online, available at: https://www.imf.org/en/News/Articles/2021/07/28/na-072821-five-things-to-know-about-the-informal-economy#:~:text=The%20informal%20economy%20is%20a%20global%20phenomenon%2C%20but%20there%20is,15%20percent%20in%20advanced%20economies.
[55] Gomes D, 2024, Gender and Business Cycles, IMF Gender Notes, online, available at: https://www.imf.org/-/media/Files/Publications/GNS/2024/English/GNSEA2024001.ashx

Exogenous shocks, however, lay bare deep gender inequalities that are to the detriment of women entrepreneurs and workers.[56] Outside of agriculture, 55% of women in middle income economies, and 78% in low-income economies, were in informal employment. Women are often overrepresented in many sectors, including service based informal micro enterprises, that are hardest hit by economic shocks such as the COVID 19. Globally, women's employment declined by 4.2% between 2019 and 2020, while men's employment declined by 3%. Social and cultural gendered norms, and power dynamics, result in women experiencing the worst effects of climate related shocks.[57] Further, women's incomes take longer to recover from income shocks; due to the nature of their work, often precarious, low paid and low skilled employment.

Macro-economic shocks have broader impacts too, partly through their impact on MSMEs and income from employment. Financial crises have been found to have a statistically significant relationship with poverty and income distribution.[58] A statistically significant relationship has also been found between poverty levels, employment deficits and the risk of conflict.[59] Financial shocks could therefore increase the risk of conflict, by increasing poverty. However, the statistical link disappears once country specific characteristics, such as the policy response and institutional and regulatory quality, are controlled for.[60] The transmission between shocks and conflict, can be influenced by institutions and regulations.

Terms of trade shocks also increase the likelihood of conflict. During a negative terms of trade shock, resulting in a deterioration of the balance of payments, the likelihood of a rise in the intensity of conflict increases. The impact is more intense where income inequality and employment deficits are higher and fiscal capacity limited. Under fiscal capacity, external debt is more relevant than the fiscal balance or domestic debt. Overall, terms of trade shocks have been found to have heterogenous consequences on the incidence and intensity of conflicts, and the impact is affected by macroeconomic, policy, regulatory and institutional factors and geographical conditions.[61] Policy, regulatory and institutional factors that contribute to an economy's ability to respond to shocks and stresses are considered in the following sections.

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[56] ILO, 2020, A Gender Responsive Employment Recovery: Building Back Fairer, Policy Brief, online, available at: https://www.ilo.org/media/396926/download

[57] UKAID, 2023, Women's Economic Empowerment: An Evidence Review of Progress Since the UN High Level Panel in 2016, online, available at: https://assets.publishing.service.gov.uk/media/64915f6e103ca6000c03a1b5/WOW_Helpdesk_Query_71_women_s_economic_empowerment_drivers.pdf

[58] World Bank, 2022, Poverty and shared prosperity 2022: Correcting course, online, available at: www.worldbank.org/en/publication/poverty-and-shared-prosperity

[59] Collier, P and A Hoeffler, 2004, Greed and grievance in civil war, Oxford Economic Papers, vol. 56, no. 4

[60] Djankovic, S and M Reynal- Querol, 2010, Poverty and civil war: Revisiting the evidence, The Review of Economics and Statistics, vol. 92, no. 4

[61] Leepipatpiboon, P et al, 2023, Macro Economic Shocks and Conflict, International Monetary Fund Working Papers, vol. 2023, no. 68

3. What factors contribute to an economy's ability to respond to shocks and stresses and adapt to new opportunities and threats?

LMIC are subjected to a range of frequent shocks, that are increasing in frequency and severity. The severity and frequency of recent shocks has seen an erosion in the fiscal ability of many LMIC to respond to future shocks and stresses.[62] This section identifies key factors that contribute to an economy's ability to respond to shocks and stresses, and identifies recommendations to reverse this erosion of capability.

3.1 Measures of economic resilience

Several indicators of capability to respond to shocks and stresses exist. Their adoption by policy makers is confounded by the complexity and dynamism of the mechanisms under consideration, data availability and the heterogeneity of economies, businesses and shocks.[63] Prior to the GFC, a resilience indicator was formulated by the United Nations World Institute for Development Economics Research. This consisted of i) macroeconomic stability, ii) micro economic market efficiency, iii) good governance; and iv) social development.[64] More recently construed indicators demonstrate that it would have been possible to identify which countries would encounter serious economic and financial problems, if a major exogenous shock, such as the COVID 19 pandemic, materialised.[65] Building on our definition of resilience, we consider macroeconomic resilience as comprising of two dimensions:

- Capacity to withstand the immediate impact of an adverse economic exogenous shock:
    - External financing needs;
    - External solvency;
- Capacity to promptly respond to the effect of an adverse economic exogenous shock;
    - Fiscal balance as a ratio of GDP;
    - Government indebtedness;
    - Deviation of inflation from target; and,

[62] World Bank, 2023, Global Economic Prospects, https://openknowledge.worldbank.org/server/api/core/bitstreams/f629931d-c801-5a71-90e8-ae73a50fdd4a/content
[63] Hallegate, S, 2014, Economic resilience: Definition and measurement, World Bank Policy Research Working Paper: 6852, online, available at: https://documents1.worldbank.org/curated/en/350411468149663792/pdf/WPS6852.pdf
[64] Briguglio, L et. al., 2008, Economic vulnerability and resilience, concepts and measurements, UNUWIDER, Research Paper 2008/55 http://www.wider.unu.edu/publication/economic-vulnerability-and-resilience#:~:text=Concepts%20and%20Measurements,the%20effects%20of%20such%20shocks.
[65] Rojas Suares, L, 2023, Identifying macroeconomic resilience to external shocks in emerging and developing economies, Centre for Global Development, https://www.cgdev.org/publication/identifying-macroeconomic-resilience-external-shocks-emerging-and-developing-countries

- Institutional and regulatory quality (as a proxy for the business environment: this captures perceptions of the ability of authorities to design and implement sound private sector policies).

These dimensions are complementary to those of Sovereign Ratings Methodologies. For example, Moody's methodology considers i) economic strength and ii) institutions and governance as determining economic resilience.[66] When complemented with fiscal strength, this allows for determinations to be made of economic strength. Measures of vulnerability are then included to define the scorecard indicated outcome. Other resilience indices are described in Section 6. Some of these capture trade relations, domestic value addition in services and investment in research and development.

With each shock and country being different, the relative importance of the six criteria in the two dimensions will differ to each shock and country. For example, a global financial shock will have a greater requirement for financing and solvency where the effected country is reliant on external financing, as many lower income countries are. This requirement also leads to vulnerability. Meanwhile all shocks, require capacities to promptly respond to the effect of an adverse shock. This is partly dependent on policy space, and elements of the business environment such as institutional and regulatory quality.

The four case study countries have varying scores in this resilience indicator. This is displayed in Table 2. Only Malaysia scored positively on the scale of -1 to 1. There is a close ordering of country scores in the resilience indicator, with the World Bank's assessment of countries' risk of default in the aftermath of shocks.[67]

Table 3: Resilience indicators in 2019[68]

Brazil	Egypt	Ethiopia	Malaysia
- 0.2745	- 0.4586	- 0.8430	0.3313

3.2 Capacity to withstand the impact of an adverse shock

Local capital markets in LMIC are generally underdeveloped and are concentrated. LMIC are therefore dependent on external sources of funding. During the GFC heightened integration through trade, foreign direct investment and remittances, resulted in lower demand for LMIC exports and lower remittance and FDI inflows. The GFC saw financing needs in low-income countries, alone, increase by US$ 25 billion.[69] By the COVID 19 pandemic in 2020, greater integration had resulted in greater risks to financial stability. The risks of sudden stops, and contagion, were therefore greater.

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[66] Moody's, 2022, Rating methodology: Sovereigns, online, available at: https://ratings.moodys.com/api/rmc-documents/395819
[67] World Bank, 2024, Debt Sustainability Analysis, online, available at: https://www.worldbank.org/en/programs/debt-toolkit/dsa
[68] Rojas Suares, L, 2023, Identifying macroeconomic resilience to external shocks in emerging and developing economies, Centre for Global Development, https://www.cgdev.org/publication/identifying-macroeconomic-resilience-external-shocks-emerging-and-developing-countries
[69] IMF, 2009, The implications of the global financial crisis for low income countries, online, available at: https://www.imf.org/en/Publications/Policy-Papers/Issues/2016/12/31/The-Implications-of-the-Global-Financial-Crisis-for-Low-Income-Countries-An-Update-PP4371

2.1.1 External financing needs

When facing an adverse external shock, countries must be able to access resources to full fill their payments. This provides space to be able to respond domestically. Proof of liquidity is essential in the absence of hard currencies. Countries with small amounts of short-term external debt, large accumulations of foreign exchange and small current account deficits, benefit from increased credit worthiness and this enhances resilience. LMIC with large amounts of short term external debt, small foreign exchange balance and large current account deficits, suffer from lower credit worthiness and this lower resilience. Meanwhile, sufficient foreign currency reserves also allow for imports to be financed when export proceeds reduce during a shock, thereby building resilience.

Recommendation

- Governments in LMIC should manage short term external debt, foreign exchange accumulations and current account deficits to allow for flexibility in managing the immediate stresses of exogenous economic shocks
- Development partners should continue to support LMIC in accessing resources to full fill their payments, conditionality should allow for addressing internal and external imbalances

Country experience in external financing

Case study countries have different external financing needs. Egypt, Malaysia and Brazil all had current account deficits and short-term debt obligations of between 70% and 77% of international reserves in 2019. These countries were therefore more able to respond to the immediate stresses of the pandemic, and demonstrated higher levels of macroeconomic resilience. Ethiopia's ratio was less favourable at 185%. As a result, Ethiopia had to rely on official transfers and its limited reserves to demonstrate the availability of resources to meet payment dues on external debts and imports. Ethiopia entered the pandemic with low levels of macroeconomic resilience, and this has since worsened.

- **Brazil** is protected by adequate external reserves, a flexible exchange rate regime and an external position broadly in line with fundamentals. This resilience stems from decades of experience in managing shocks, and emphasis is now given to building buffers during normal times. Fiscal responsibility laws have assisted with this. The fiscal rules have enabled Brazil's resilience between 2022 and 2024, though an enhanced fiscal framework would reduce uncertainty.
- In **Egypt**, macro-economic imbalances worsened following the GFC. Current account deficits and external public debt increased, making Egypt at risk from outflows. However, reforms since 2014 to ease macroeconomic imbalances, such as the floating of the exchange rate, and mobilize domestic financing enabled the country to enter the recent period of successive crises, with sufficient flexibility.
- **Ethiopia** has a long history of external distress. Ethiopia's external debt stock increased from US$ 1.8 billion to US$ 10 billion between 1990 and 2010. Ethiopia's current account deficit and short-term debt ratio to international reserves significantly constrained the management of the immediate impact of the pandemic related economic crisis. Currently, external debt servicing is 22% of exports. International reserves have fallen to around two weeks of imports. With exports not yet taking off under the Growth and Transformation Plans, Ethiopia is facing daunting external sector policy choices and has applied for external debt restructuring and support from the International Monetary Fund.
- **Malaysia** relies on short term capital flows, which poses risks. However, the lessons from the Asian Financial Crisis, imposed effective macroeconomic management on Malaysia. This has provided a platform of resilience for the more recent period of shocks. In March 2023, reserves were able to fund 5.1 months of imports and were 1.1 times the value of total short term external debt.

2.1.2 External solvency

Countries must be able to meet their external obligations to manage immediate stresses. External solvency refers to an economy's capacity to avoid defaulting on external (private and public) debt obligations, while maintaining sufficient credit ratings to access international financial markets and respond to stresses. Those that cannot, are less able to respond to stresses arising from the immediate impact of exogenous shocks.

The external public debt position of LMIC has deteriorated in the past two decades:

- From 2020-2023, the number of sovereign debt defaults in developing countries has surged to 18, more than the previous 20 years.[70]
- Public debt as a share of exports in developing counties has increased, as a median value, from 71% in 2010 to 112% in 2022.[71]
- The portion of external public debt owed to private creditors had also risen to 62% of developing countries' total external public debt in 2021.

The present value of external debt as a percentage of GNI, as displayed in Table 3, is the most appropriate measure of external debt sustainability. The net present value is only available for 2022, for three of the case study countries. Recently construed databases of fiscal space include total external debt as a percentage of GDP. Figure 3 shows that the external debt positions of case study countries have varied significantly since 1990.

Table 4: Net present value of external debt as a % of Gross National Income, 2022[72]

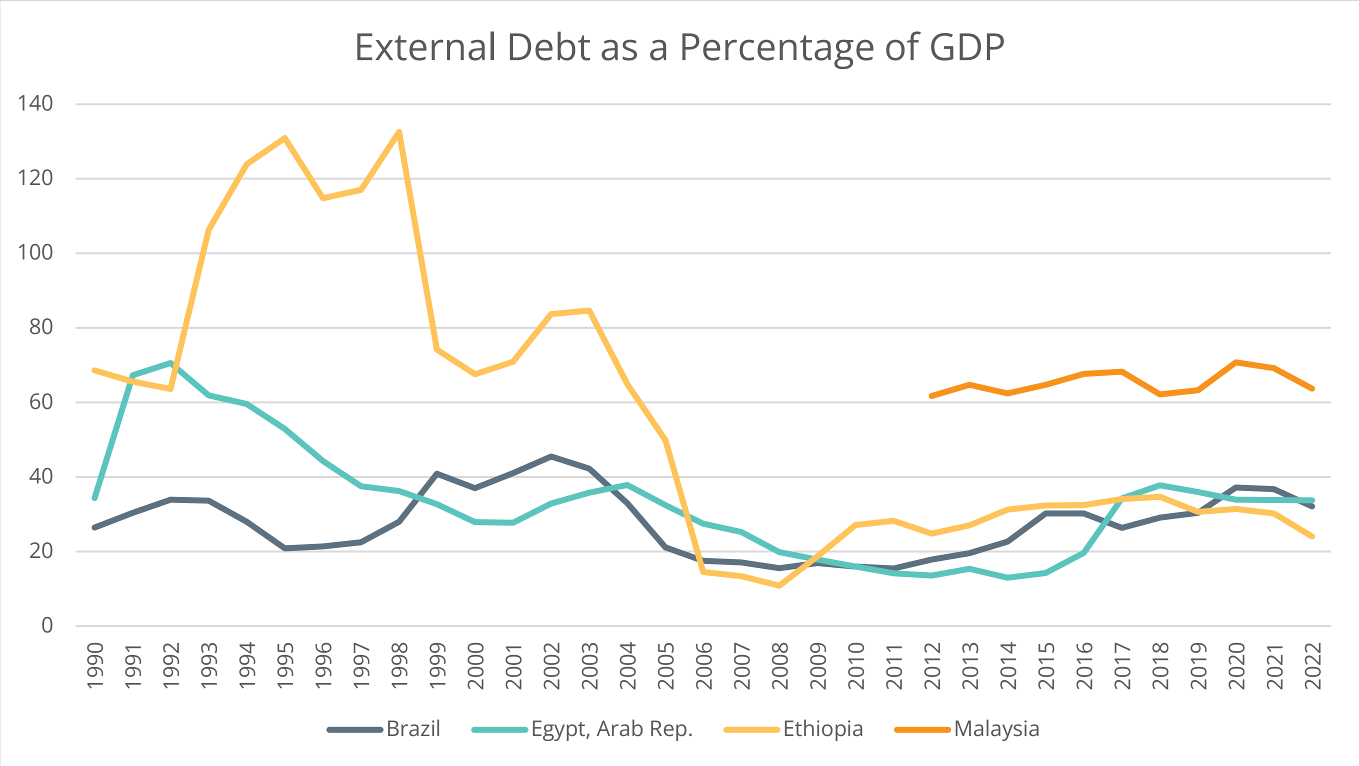
Brazil	Egypt	Ethiopia	Malaysia
9%	21%	17%	Not available

Recommendation

- Governments of LMIC should manage the present value of external debt, as a percentage of Gross National Income, within bounds of sustainability
- Governments of LMIC should actively rebuild buffers during normal times

[70] World Bank, 2023, International debt report, online, available online: https://openknowledge.worldbank.org/server/api/core/bitstreams/83f7aadd-dc5a-406b-98d4-9624e93993e5/content
[71] UNCTAD, 2023, A world of debt: A growing burden to global prosperity, online, available at: https://unctad.org/system/files/official-document/osgmisc_2023d4_en.pdf
[72] World Bank, 2024 World Development Indicators, online, available at: https://databank.worldbank.org/source/world-development-indicators/Series/DT.DOD.PVLX.GN.ZS

Figure 3: External debt as a percentage of GDP in case study countries, 1990 - 2022



Country experience in external solvency

Limits of external debt to GNI vary by country; countries with fast growing economies and exports are more likely to sustain higher external debt levels while achieving resilience. The composition of debt also matters, especially when debt becomes due during times of crisis. Malaysia has been able to sustain high external debt levels because of the surplus in the current account. Egypt and Ethiopia both reduced their external debt positions in the 1990s. For resilience, external debt positions need to be better balanced against the balance of payments position and growth rates.

- **Brazil's** external debt has been increasing from 2009, as shown in Figure 9. External debt declined to 35% of GDP and 200% of exports in 2022, compared to 41% of GDP and 236% of exports in 2021, as demand rebounded and buffers were rebuilt. Short term external financing needs are moderate at 11% of GDP, but capital flows are sensitive to global financial conditions.
- **Egypt** has sought to manage its external debt position since the 1990s. In the past decade, increases in public debt have been exacerbated by exchange rate devaluations and increased debt servicing costs. Authorities now need to generate foreign currency to pay off US$28 billion in maturing foreign debt and interest, and another US$ 20 billion in 2024. This has led Egypt to seek financing from Gulf States and the IMF.
- **Ethiopia's** external debt to GDP ratio has declined since 1998, but a severe liquidity risk has emerged- external debt servicing to exports have reached 22%. This is above the IMF ceiling of 15%. As Ethiopia breached the Debt Sustainability Analysis threshold, Ethiopia is now classified as at high risks of debt distress. Ethiopia was one of three African countries to default on their external debt between 2020 and 2023. Ethiopia would be challenged to respond to further economic stresses, without external support.
- **Malaysia** can service high external debt service obligations because of its current account surplus and because one third of external debt is ringgit denominated. Short term external debt accounts for 42% of external debt; and this is held under inter group borrowing (among banks) or trade finance (financed by exports).

3.3 Capacity to promptly respond to the effect of a shock on MSME

LMIC have adopted counter cyclical policies during shocks, to further resilience. Evidence suggest that policy in advanced economies is more countercyclical, and in developing countries it is more procyclical, during normal business cycles.[73] A norm in the policy response to severe stresses, broadly adopted during the GFC and normalised during the COVID 19 pandemic, has been the implementation of counter cyclical policies across countries.[74] Even during normal business cycles, some LMIC have 'graduated' from procyclical to counter cyclical policies, as institutional quality and access to financial markets have improved.[75]

The adoption of effective counter cyclical policies across LMIC is constrained by policy space. Despite the normalisation of countercyclical policies in responding to severe shocks, a lack of fiscal and monetary policy space can constrain the ability of Governments to act.[76] For example, the scope and size of monetary, fiscal and prudential policy packages was found to determine levels of bank lending during the COVID 19 pandemic.[77]

Regulations and institutions in LMIC do not sufficiently account for the specific needs of MSMEs, this hampers resilience. The ability of Governments to act is determined by the institutional and regulatory quality of the country. This is particularly relevant to the inclusiveness of the responses to exogenous shocks. There is a need for a dual mandate for macroeconomic managers as i) guardians of macro stability and ii) inclusive development, that is more cognizant of the needs of MSMEs. Often, the specific needs of different segments of MSME are overlooked, in favour of larger (formal) businesses. The smaller the firm, the more their needs are likely to be overlooked. Authorities also require more policy freedom to implement sound and inclusive policies and regulations. This is partly determined by conditionality imposed when seeking access to external financial support.

3.3.1 Fiscal balance as a ratio of GDP

The fiscal balance as a ratio of GDP is a key determinant of macroeconomic resilience, but LMIC are running consistent, and often deep, deficits.[78] Countries with strong fiscal accounts prior to a shock are better positioned to undertake counter cyclical policies, that can provide support to MSMEs, than those with persistent and large fiscal deficits. This is particularly relevant to low-income countries, where local capital markets are emerging and access to international capital markets is limited. Case study country experience with fiscal balances in displayed in Figure 4.

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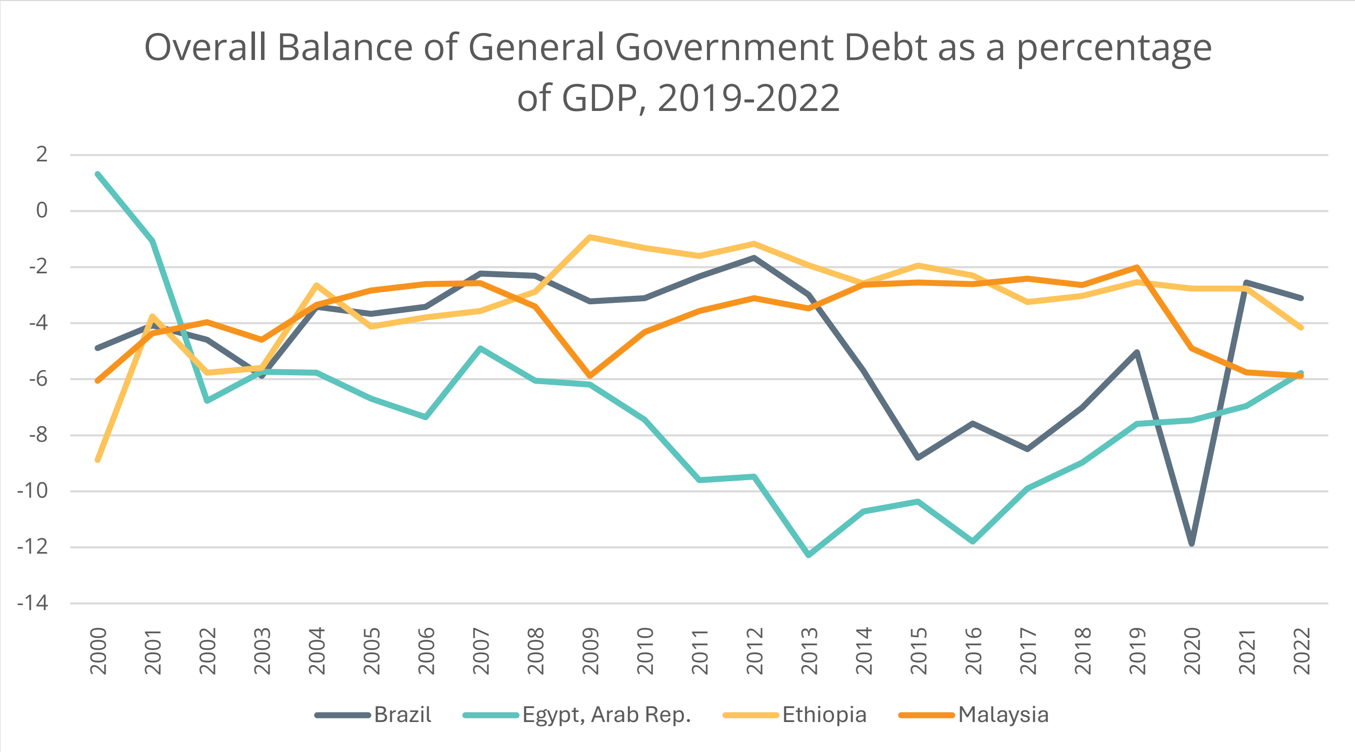
[73] Heimburger, P, 2023, The cyclical behaviour of fiscal policy: A meta analysis, Economic Modelling, vol. 123, online, available at: https://www.sciencedirect.com/science/article/pii/S0264999323000718
[74] Jalles, J, et al, 2023, Revisiting the counter cyclicality of fiscal policy, IMF Working Paper, online, available at: https://www.imf.org/en/Publications/WP/Issues/2023/04/29/Revisiting-the-Countercyclicality-of-Fiscal-Policy-532952
[75] Frankel, J, et al, 2013, On graduation from fiscal procyclicality, Journal of Development Economics, vol. 100, online, available at: https://www.sciencedirect.com/science/article/abs/pii/S0304387812000533
[76] Ferrer, J, 2022, Policy space index: Short term response to a catastrophic event, IMF Working Paper, online, available at: https://www.imf.org/-/media/Files/Publications/WP/2022/English/wpiea2022123-print-pdf.ashx
[77] Kirti, D et al, 2023, What policy combinations worked? The effect of policy packages on bank lending during COVID 19, online available at: https://www.imf.org/en/Publications/WP/Issues/2023/02/03/What-Policy-Combinations-Worked-The-Effect-of-Policy-Packages-on-Bank-Lending-during-COVID-529118
[78] Ayhan Kose, M et al, 2022, A Cross Country Database of Fiscal Space, online, available at: https://www.sciencedirect.com/science/article/abs/pii/S0261560622000857?via%3Dihub

Figure 4: Fiscal Balance as Percentage of GDP, 2000 - 2022[79]



Recommendation

- Governments of LMIC should achieve sustainable fiscal balances as a percentage of GDP
- Governments of LMIC should actively seek to rebuild fiscal buffers during normal times

Country experiences with fiscal balances

Case study countries ran consistent negative fiscal balances as a percentage of GDP from 2001 to 2022, and this has hampered resilience. Partly, this is because deficits are being used to finance debt, rather than invest in the Sustainable Development goals. Negative spikes occurred in Brazil, Egypt and Malaysia during the GFC. Ethiopia, with undeveloped local capital markets, reduced the fiscal balance during the GFC. While Brazil's fiscal balance was moderating before the pandemic, substantial expenditure and the contraction in economic activity resulted in a negative spike. This soon recovered.

- In **Brazil**, rather than supply side business cycles- policy change and exogenous shocks have conditioned economic activity. Unsound public finance has been identified as the ultimate cause of poor macro-economic results. To address this, Brazil has been an early adopter of fiscal rules to promote resilience, and the new proposed fiscal rules aim to limit expenditures growth to less than revenue growth over time to build buffers.
- In **Egypt**, the fiscal balance worsened since the GFC, however the gains from the Comprehensive Economic Reform Programme, initiated in 2016, saw balances recover to 2022. This has improved resilience. This fiscal space enabled Egypt to implement a budget stimulus package during the pandemic that was greater than that implemented during the GFC. Egypt is now embarking on maintaining fiscal prudence and efforts to mobilise domestic revenue to manage fiscal imbalances, while managing the impact of price shocks.

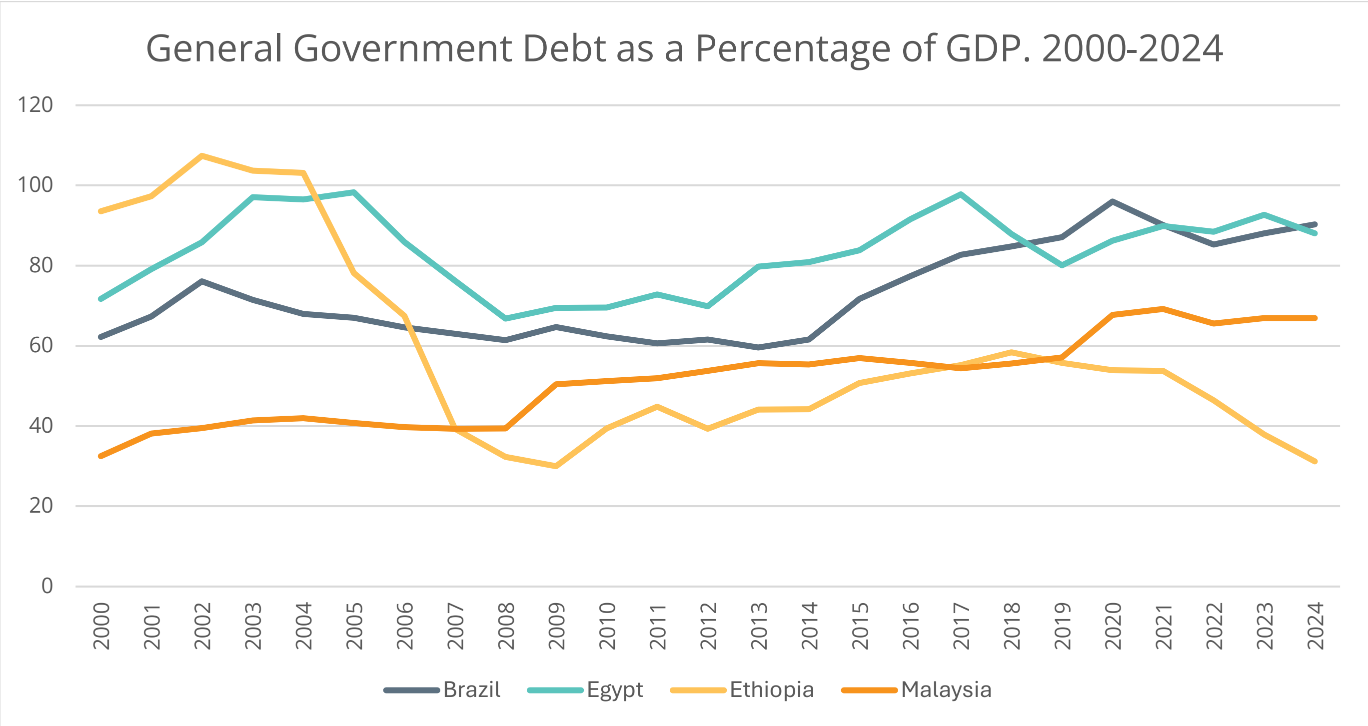
[79] Ayhan Kose, M et al, 2022, A Cross Country Database of Fiscal Space, online, available at: https://www.sciencedirect.com/science/article/abs/pii/S0261560622000857?via%3Dihub

- In **Ethiopia**, the fiscal balance began deteriorating during the GFC- hampering economic resilience. This again worsened during the pandemic, and has further deteriorated because of military expenditures and weak revenue performance. Tax to GDP ratios are around 10-12%, gross savings are below the investment needs of the country and fiscal space has disappeared.
- In **Malaysia**, fiscal balances dipped following the GFC and the pandemic, but soon recovered to enable resilience. Balances reached -6% in 2009 and 2022. While fiscal policy was expansionary during the pandemic, policy transitioned appropriately to post pandemic tightening in 2022. This was enabled by pent up demand and high export performance. Tax to GDP ratios are 12%, lower than regional countries. The new Public Finance and Fiscal Responsibility Law sets a target of reducing the fiscal deficit to 3% of GDP within three-five years. This will support rebuilding fiscal buffers, and will enable resilience.

3.3.2 Government indebtedness

General government debt levels are at elevated levels in LMIC, hampering resilience. All case study countries achieved reductions in general government debt as a percentage of GDP in the 2000s, partly because of debt cancellation initiatives. Debt ratios increased following the GFC, as several case study countries failed to normalise fiscal policy following this crisis and rebuild buffers. In Brazil, this was partly due to the timing of election cycles.[80] This prolonged accumulation of debt resulted in case study countries entering the COVID 19 pandemic with elevated debt levels. The levels and solvency of debt in Ethiopia significantly hampered resilience during this shock, resulted in Ethiopia seeking access to external support.

Figure 5: General Government Debt as a Percentage of GDP, 2000-2024[81]



[80] Bonomo, M, et al, 2015, The after crisis government driven credit expansion in Brazil: A Firm Level Analysis, online, available at: https://www.sciencedirect.com/science/article/pii/S0261560615000327
[81] IMF, 2024 General government debt as a percentage of GDP, IMF Data Mapper, online, available at: https://www.imf.org/external/datamapper/GGXWDG_NGDP@WEO/OEMDC/ADVEC/WEOWORLD

Recommendation

- Governments of LMIC should manage general government debt, as a percentage of GDP, to allow for space to respond to respond to crises.

Country experiences with Government indebtedness

Debt is more expensive in developing countries, with bond yields averaging 11.6% in Africa and 7.7% in Latin America- compared to 1.5% in Germany. The cost of servicing debt has reduced the availability of resources to fund the Sustainable Development Goals and build resilience. High interest rates, and existing high debt levels, is resulting in a cycle which is hampering resilience. This can be unwound, and resilience furthered, by healthier fiscal balances and economic growth. However, medium term growth rates are projected to decline on the back of mediocre productivity growth, insufficient levels of investment and scarring from the pandemic

- In **Brazil**, debt levels stabilised following the GFC and then increased from 2014 to 2020. Debt levels are above regional averages. Following this, discussions over reframing spending caps raised the cost of financing. The risk of fiscal slippage became a weakness in Brazil's macro-economic framework. New fiscal laws, include escape clauses in the event of public calamity, which allow flexibility in the fiscal response.
- In **Egypt**, public debt increased from the GFC to 2017, and again from 2019 to 2022. Debt vulnerability in Egypt is driven by longstanding structural imbalances and poor institutional performance. As much of this debt is short term, Egypt is vulnerable to increases in interest rates. Egypt is currently being supported with an Extended Fund Facility arrangement.
- In **Ethiopia**, debt levels fell prior to the GFC and rose during the fiscal prolificacy from 2010 to the pandemic. Debt has grown at a faster rate than GDP for most of the last 40 years, and tax to GDP ratios are only 6%. Debt levels has since fallen to solvable levels, but debt servicing to export ratios have reached 22%. Debt servicing now accounts for more expenditure, than poverty focussed social spending.
- In **Malaysia**, general government debt has been increasing since 2000. Government revenues as a percentage of GDP had been falling, partly due to negative tax buoyancy. Government debt spiked during the pandemic as Malaysia implemented a fiscal response larger than other countries in the region. Malaysia has now set itself a target of reducing Government debt to 60% of GDP, as a means to restore buffers.

3.3.3 Deviation of inflation from target

Changes to interest rates are a key component of effective counter cyclical policies during stresses. The extent of inflationary pressure before an adverse shock, influences the capability of conventional countercyclical monetary policy. If an adverse economic shock leads to a liquidity shortage and a contraction in domestic credit growth, central banks may consider lowering the policy interest rate. But if an economy is facing high and persistent inflation, lowering interest rates could further inflation.

Table 5: Deviation of inflation in case study countries from target (percentage points), 2019

Brazil	Egypt	Ethiopia	Malaysia
0.05	0	11	0

Case study countries were able to reduce interest rates during the COVID 19 pandemic, but subsequent increases in interest rates have resulted in a debt burden among MSMEs. Most case study countries demonstrated negligible deviations of inflation from target in 2019. Table 4 shows that Brazil, Egypt and Malaysia were showing small deviations of inflation from target. They were able to reduce interest rates during the COVID 19 pandemic and then increase them as upward pressures was exerted on prices because of i) the surge in demand and ii) Russia's invasion of Ukraine. Ethiopia however, was experiencing high rates of inflation in 2019. Ethiopia was therefore able to reduce interest rates, but this came at the price of higher prices in 2021 and 2022. In some case study countries, interest rates have increased after the COVID 19 pandemic. This has created scarring among MSMEs that took on debt during the COVID 19 pandemic, to survive.

3.3.4 Institutional and regulatory quality

The ability of governments to formulate and implement sound private sector policies matters for resilience. This can be enabled by effective social dialogue. This is discussed in Section 5. While institutional and regulatory quality may change slowly over time, the quality of institutions and regulations is important for the effective delivery of policies and regulations that prevent macro-economic imbalances and support MSMEs in weathering stresses. For example, measures of institutional quality are included in Debt Sustainability Assessments, as well as in the consideration of eligibility for lines of credit. Of the six indicators in the Worldwide Governance Indicators, regulatory quality is most synonymous with business environment reforms. This indicator captures perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development. It is constructed from 35 different sources of data.[82]

There is a need for regulations to be more cognisant of the needs of MSMEs. The regulatory quality indicator does not have a specific focus on MSMEs. There is no index relating to the ability of LMIC Governments to formulate and implement sound policies and regulations for MSMEs. The closest is the Organisation for Economic Cooperation and Development's Small and Medium Enterprise Policy Index.[83] Among LMIC, this is available for Latin American, Eastern European and Western Balkan countries only.

Progress in regulatory quality is slow and seems to reverse between crises. Figure 6 shows how case study countries have performed in the regulatory quality indicator since 2006. 2.5 represents a perfect score, and -2.5 represents the worst possible score. Case study countries do not show uniform improvements in regulatory quality. Only Malaysia shows gradual improvements. Estimations for Brazil, Egypt and Ethiopia all worsened between the GFC and the onset of the COVID 19 pandemic. This constraints resilience, since during normal business cycles LMIC Governments have not been making progress in formulating and implementing sound private sector policies. That scores improved slightly during the COVID 19 pandemic, demonstrates that in times of crises Government becomes more responsive. Although many middle-income countries rebuilt policy buffers between two major shocks, improvements in regulatory quality did not complement this effort. This stop start approach to regulatory quality hampers resilience. For example, Ethiopia, which had severely constrained policy space at the onset of the COVID 19 pandemic, did not have sufficient capability to direct its constrained resources to areas of most effect. This has served to reduce resilience.

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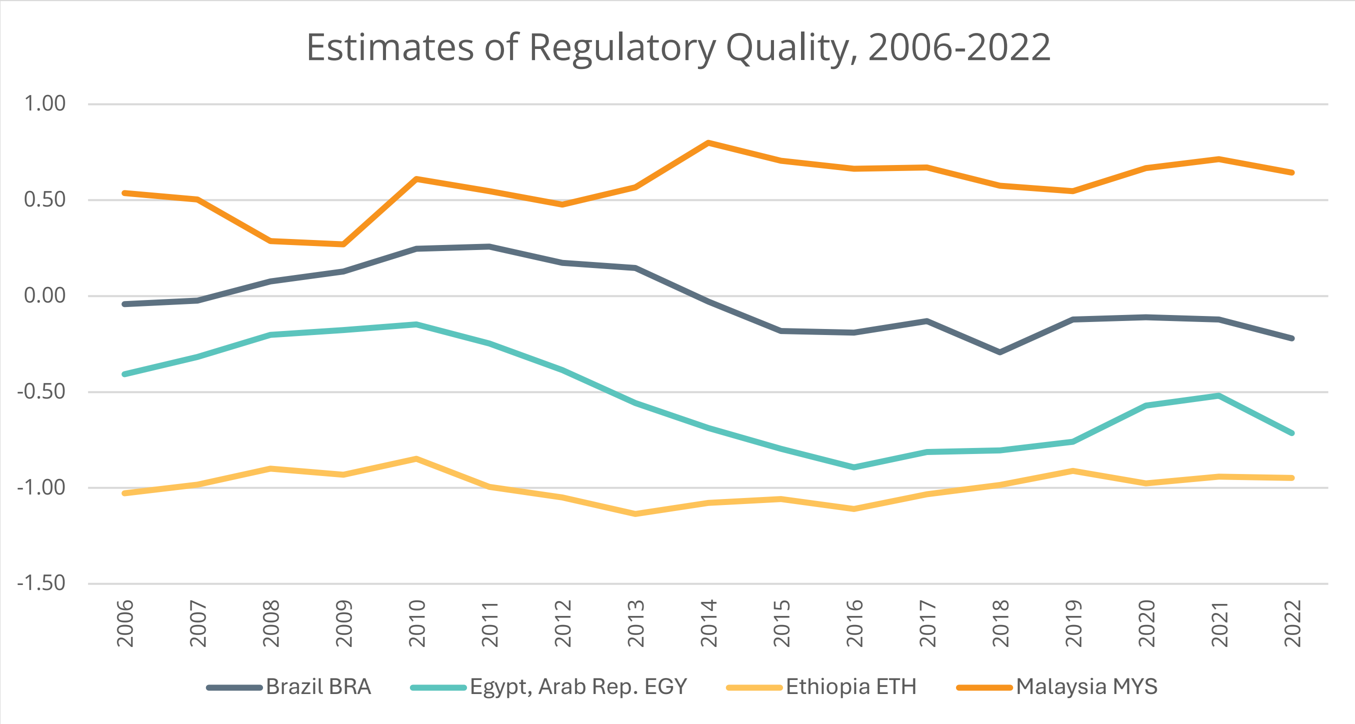
[82] World Bank, 2024, Regulatory Quality, online, available at: https://www.worldbank.org/content/dam/sites/govindicators/doc/rq.pdf
[83] OECD, 2024, SME Policy Index, online, available at: www.oecd-library.org/development/sme-policy-index-24136883

Figure 6: Estimates of regulatory quality in case study countries, 2006-2022[84]



Certainty and the efficiency of Government also promotes resilience. Government must be effective, agents must have confidence in the rule of law and corruption controlled, to effectively respond to stresses and direct support to MSMEs most at need. Table 5 displays estimates for case study countries against these topics. As an upper middle-income economy, Malaysia scores well for government effectiveness. But even here, with high scores in the Worldwide Governance Indicator, the novel nature of the COVID 19 pandemic required a degree of experimentation. Malaysia had implemented eight stimulus packages between March 2020 and April 2021, each coinciding with Movement Control Orders. This piecemeal approach created uncertainty, particularly for MSMEs.[85] During severe shocks there is a need for institutions to be able to learn fast and adapt, while striving to maintain policy certainty to achieve resilience.

Table 6: Selected World Governance Indicators: Estimates for case study countries, 2022[86]

Indicator	**Brazil**	**Egypt**	**Ethiopia**	**Malaysia**
Government effectiveness	-.059	-0.45	-0.75	0.99
Rule of law	-0.26	-0.26	-0.62	0.56
Control of corruption	-0.41	-0.66	-0.44	-0.23
MEAN AVERAGE	**-0.42**	**-0.47**	**-0.61**	**0.44**

[84] Kauffman, D and A Kray, 2023, Worldwide Governance Indicators, online, available at: https://www.worldbank.org/en/publication/worldwide-governance-indicators
[85] Loong, Y, 2022, The Malaysian economy and COVID 19: Policies and responses from January 2020-April 2021, online, available at: https://unctad.org/system/files/official-document/BRI-Project_RP30_en.pdf
[86] Kauffman, D and A Kray, 2023, Worldwide Governance Indicators, online, available at: https://www.worldbank.org/en/publication/worldwide-governance-indicators

Recommendation

- Governments of LMIC should increase emphasis on improving institutional and regulatory quality for MSME, especially during normal business cycles so that this does not recede, to enable effective responses to shocks
- Development partners should consider establishing indices to capture the ability of LMIC governments to formulate and implement policies relevant to MSMEs and should maintain support to regulatory improvement to MSMEs during normal cycles

3.4 Summary

Ethiopia, a low-income country, is the least resilient of the case study countries. While Ethiopia has weathered recurring severe economic shocks, it now has the least ability to respond to the immediate impact of an adverse economic shock, and the least capacity to respond to the effect of a shock.[87] The GFC represented a turning point for Ethiopia. Further, as industrialisation has not taken off in the same way that it did in East Asia, this has reduced resilience.[88] Ethiopia's regulatory quality is also insufficient, to channel limited resources to areas of most effect. However important developments are under way, including the liberalisation of financial markets and telecommunications. The Home Grown Economic Reform Agenda: A Pathway to Prosperity aims to address these imbalances and safeguard macro financial stability.[89]

Malaysia, a middle-income country, was more able to weather the GFC and COVID 19 pandemic because of how it responded to lessons learnt during the Asian Financial Crises, and since. It also benefits from a consistent current account surplus and a favourable short term debt position. Those countries that learnt from the GFC and were able, rebuilt fiscal buffers in subsequent years.[90] They were subsequently able to deploy a sizeable monetary and fiscal policy package during the COVID 19 pandemic. In Brazil, forward planning has included elements of Risk Informed Development through fiscal legislation and the rebuilding of buffers. This has increased resilience to macro-economic shocks.[91]

This finding corresponds with the findings of other research on the response to the COVID 19 pandemic. A less diversified set of interventions was employed in low-income countries with less policy space, with debt finance interventions accounting for half of all measures deployed where public finance was constrained. High income countries relied less on debt financing or tax relief, and more on employment support measures.[92] The next section considers the effectiveness of different response packages.

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[87] World Bank, 2023, Poverty and equity brief: Ethiopia, online available at: www.databankfiles.worldbank.org/public/ddpext_download/poverty/987B9C90-CB9F-4D93-AE8C-750588BF00QA/current/Global_POVEQ_ETH.pdf
[88] Gebrehiwot, A, 2021, Boosting Ethiopia's industrialisation: What can be learned from China, UNCTAD BRI Project, TRP 23, online, available at: https://unctad.org/system/files/official-document/BRI-Project_RP23_en.pdf
[89] GoE, 2020, A homegrown economic reform agenda: A pathway to prosperity, online, available at: https://www.mofed.gov.et/media/filer_public/38/78/3878265a-1565-4be4-8ac9-dee9ea1f4f1a/a_homegrown_economic_reform_agenda-_a_pathway_to_prosperity_-_public_version_-_march_2020-.pdf
[90] Claessens, S et al, 2010, Lessons and policy implications from the Global Financial Crisis, IMF Working Paper no. WP/10/44
[91] ODI, 2019, Risk Informed Development: From crisis to resilience, online, available at: https://odi.cdn.ngo/media/documents/12711.pdf
[92] Cirera, X et. al., Policies to support business through the COVID shock: A firm level perspective, World Bank Policy Research Working Paper: 9506, online, available at: https://documents1.worldbank.org/curated/en/188461610547807479/pdf/Policies-to-Support-Businesses-through-the-COVID-19-Shock-A-Firm-Level-Perspective.pdf

With exogenous shocks expected to increase in incidence and severity, concerted action must now be taken to increase resilience. This is particularly pressing given multiple concurrent threats. All countries should now adopt the principles of Risk Informed Development to build their resilience.[93] The purpose of this is to prepare economies for future risks, taking proactive measures to mitigate risks and build the resilience of economies. Doing so will enable the understanding of multiple concurrent threats and complex risks to, and arising from, development decisions, while acting on that knowledge.

Recommendations

- Macro-economic managers in LMIC should balance a dual mandate of i) guardians of macro-economic stability and ii) inclusive development
- LMIC countries should take concerted action to adopt the principles of Risk Informed Development- to encompass multi hazards and the coping capacities of economies and businesses, while acknowledging the role of development decisions in creating known and unknown risks
- Donors should channel support towards the effective adoption of Risk Informed Development practices in LMIC, and in their programmes

[93] UNDP, 2022, The UNDP approach to risk-informed development, online, available at: www.undp.org/publications/undp-approach-risk-informed-development

4. Which business climate reforms have effectively responded to global shocks, and which ones have not? Why is this the case?

Shocks and stresses require responses outside of those relevant to normal business cycles. In normal times, Government support to private firms consists of encouraging investment, through tax incentives or access to finance for specific firms or sectors for example, and stabilisers implied by the tax system. During major crises, public support can avert economic collapse, and the collapse of MSMEs and income opportunities. Recovery periods then allows for innovation and the efficient reallocation of labour. [94]

This section focuses on the relevance and efficiency of different business environment reform measures introduced during the COVID 19 pandemic. Evidence on effectiveness was not identified in the literature, so drivers of relevance and efficiency are considered. Focus is given to the COVID 19 pandemic because of this severity and recency of this crisis, and because it spanned demand and supply stresses. Further, the COVID 19 pandemic has been the focus of researchers. This section also introduces a range of regulatory options that can be deployed, and proposes their relevance to supply and demand shocks (of differing durations).

4.1 Trade-offs and context determine the relevance of measures

Daunting trade-offs face policy makers in LMIC. All countries face trade-offs when responding and there is considerable heterogeneity across countries and shocks.[95] What may be an effective response in one economy to a particular stress, may not be applicable in another. Key drivers of heterogeneity include:

- The extent of decent work deficits;
- The sectoral composition of the economy, which determine how severe different stresses may be;
- The extent of policy space; and,
- The institutional setting and the effectiveness of social dialogue.

[94] Akcigit, U and J Van Reenan, The economics of creative destruction, online, available at: https://www.hup.harvard.edu/file/feeds/PDF/9780674270367_sample.pdf
[95] Hausman, R. and U. Schetter, 2022, Horrible trade offs in a pandemic: Poverty, fiscal space, policy and welfare, World Development, https://www.sciencedirect.com/science/article/pii/S0305750X22000092

Significant heterogeneity in needs, capabilities and responses was demonstrated during the COVID 19 pandemic. During the COVID 19 pandemic advanced economies deployed fiscal and monetary support equivalent to a quarter of GDP. In low-income countries, the equivalent measure was around 3%. The probability of receiving some public support was 11% in low-income countries, 15% in lower-middle-income countries, 30% in upper-middle-income countries, and 53% in high-income countries.[96]

There are a broad range of tools that are available to be deployed. The challenge is to deploy the right tool to the task. Policymakers need to diagnose the channel of stresses and identify the MSME segments to focus on, be they priority sectors, or particularly vulnerable targets, such as young and women entrepreneurs and informal firms. Only then, can effective measures be identified.[97] This all must be done while navigating the political economy of reform.

In addressing stresses, some tools are more relevant than others and this determines effectiveness. The IMF has detailed what fiscal measures may be relevant and effective when countering short- and long-term demand shocks (such as pandemics and global financial crises), supply shocks (such as extreme weather events and conflicts in other countries) and natural disasters.[98] The International Labour Organisation has also published a menu of tools that can be deployed.[99] Table 6 builds on these sources, and identifies a menu of possible measures to stabilise the macroeconomy, and support MSME. This includes tools in fiscal, monetary and macro prudential policy, and business environment reforms.

Table 7: The range of tools to respond to exogenous economic shocks

	Demand shock		**Supply shock**	**Major natural disasters**
Tools	Temporary	Longer lasting		
Automatic stabilizers				
Unemployment income support	✓	(✓) supplement with active labour market policies	✗	✓
Job retention schemes (wage support, work time arrangements, reskilling)[100]	✓	✗	✗	✓

[96] Xavier, C, 2021, Policies to support businesses through the COVID 19 shock: A firm level perspective, online, available at: https://documents1.worldbank.org/curated/en/188461610547807479/pdf/Policies-to-Support-Businesses-through-the-COVID-19-Shock-A-Firm-Level-Perspective.pdf

[97] ILO, 2023, A framework to support small firms in developing countries navigate crisis and build resilience, online, available at: https://www.ilo.org/publications/framework-support-small-firms-developing-countries-navigate-crises-and#:~:text=Report-,A%20framework%20to%20support%20small%20firms%20in%20developing%20countries%20navigate,small%20firms%20during%20such%20conditions.

[98] IMF, 2022, Fiscal monitor: Helping people bounce back, online, available at: https://www.imf.org/en/Publications/FM/Issues/2022/10/09/fiscal-monitor-october-22

[99] ILO, 2023, A framework to support small firms in developing countries navigate crisis and build resilience, online, available at: https://www.ilo.org/publications/framework-support-small-firms-developing-countries-navigate-crises-and#:~:text=Report-,A%20framework%20to%20support%20small%20firms%20in%20developing%20countries%20navigate,small%20firms%20during%20such%20conditions.

[100] ILO, 2023, A framework to support small firms in developing countries navigate crisis and build resilience, online, available at: https://www.ilo.org/publications/framework-support-small-firms-developing-countries-navigate-crises-and#:~:text=Report-

Scale up of social protection (to informal workers and entrepreneurs)	(✓) Ready to scale up as needed	(✓) Facilitate better social well-being (equity)	✓	(✓) widen eligibility to cover affected people and not just poor people
Progressive taxes	✓	✓	✓	✓
Discretionary or ad hoc measures				
Cash transfers (to informal sector workers and entrepreneurs)	(✓) Only if targeted and severe adversity	✗	(✓) Build on current social protection system	(✓ targeted transfers
Pricing subsidies	✗	✗	✗	✗
Discretionary support to firms				
Tax deferral	(✓) If limited access to finance	✗	✗	✓
Financing measures (direct lending and public guarantees)[101]	(✓) if severe externalities exist from firm closure	(✗) should facilitate exit of non-viable firms	(✗) unless severe externalities exist)	✓
Conventional monetary policy				
Interest rate reduction	✓ then time post crisis tightening	✓	✓	✓
Reserve requirements	✓	✓	✗	✓
Unconventional monetary policy[102]				
Asset purchases	✓ (when targeted and severe adversity and network effects)	✗	✗	✗
Injecting liquidity	✓ (if banks become liquidity constrained)	✗	✗	✗
Macro prudential regulations[103]				

,A%20framework%20to%20support%20small%20firms%20in%20developing%20countries%20navigate,small%20firms%20during%20such%20conditions.

[101] IMF, 2022, Fiscal monitor: Helping people bounce back, online, available at: https://www.imf.org/en/Publications/FM/Issues/2022/10/09/fiscal-monitor-october-22

[102] Fratto, C., 2021, Unconventional monetary policies in emerging markets and frontier countries, IMF Working Paper, online, available at: https://www.imf.org/en/Publications/WP/Issues/2021/01/22/Unconventional-Monetary-Policies-in-Emerging-Markets-and-Frontier-Countries-50013

[103] Bergant, K et al, 2023, Dampening global financial shocks: Can macro prudential regulation help (more than capital controls), BIS Working Paper 1097, online, available at: https://www.bis.org/publ/work1097.pdf

	(✓) (calibrate response to systemic risks)	(✓) (calibrate response to systemic risks)	(✗) (calibrate response to systemic risks)	(✗) (calibrate response to systemic risks)
Business regulatory reforms				
Business entry, hibernation and exit reforms[104]	✓	✓	✓	✓

4.2 Challenges to assessing effectiveness

Identifying the effectiveness of business environment reforms to MSME is challenging.[105] In advanced economies there is a growing evidence base regarding the economic and financial support deployed during the COVID 19 pandemic.[106] These focus on relevance and efficiency, and for businesses focus on tax-based measures and balance sheet measures. Effectiveness has not been determined, nor have all deployed measures been considered.

Lessons from OECD countries

- Tax based measures were found to face administrative difficulties, as the tax data was based on the financial records from the previous year. In some countries, records were required for 2019 and 2020, to restrict fraud. Effective targeting was therefore challenging.
- Balance sheet policies, consisting of loans and guarantees, allow for the swift delivery of support, but this may have come at the cost of effective targeting. Despite delivering short term benefits (such as reduced bankruptcies and the reopening of businesses), risks and uncertainties surround the longer-term budgetary costs of guaranteed schemes.

There is a shortage of evidence on the effectiveness of difference response measures in LMIC. No secondary evidence was identified, which seeks to identify the effectiveness of measures to MSMEs in case study LMIC. This is partly because methodological challenges to assessing the effectiveness of business environment reform measures in LMIC abound. In LMIC, there remains a need to broaden the range of designs and methods.[107] One challenge, includes considering the effectiveness of different tools in achieving different outcomes, such as future expected sales growth, investment in digitalisation or the retention of workers.

[104] ILO, 2021, A framework to support small firms in developing countries navigate crisis and build resilience, online, available at: https://www.ilo.org/publications/framework-support-small-firms-developing-countries-navigate-crises-and#:~:text=Report-,A%20framework%20to%20support%20small%20firms%20in%20developing%20countries%20navigate,small%20firms%20during%20such%20conditions.
[105] Manuel (2015) Is there a causal link between the investment climate and growth? DFID Legal Assistance for Economic Reform Programme, online, available at: https://assets.publishing.service.gov.uk/media/591b040aed915d20f800000c/laser-evidence-paper-the-link-between-ic-reform-a.pdf
[106] OECD, 2022, First lessons from government evaluations of COVID 19 response: A synthesis, online, available at: https://www.oecd.org/coronavirus/policy-responses/first-lessons-from-government-evaluations-of-covid-19-responses-a-synthesis-483507d6/#section-d1e2739
[107] Kirkpatrick (2014) Assessing the impact of regulatory reform in developing countries, Public Administration and Development, vol. 34, p. 162-168

While correlation between measures and impacts has been partly determined across LMIC, causation has not been determined. In LMIC, monetary transfers and access to credit, which relax short term credit and liquidity constraints, were found to be correlated with higher future expected sales growth. Causation was not determined. Meanwhile wage subsidies were negatively correlated with laying off workers. These subsidies do not affect expected future sales growth; they are targeted at the continuation of the employment relationship. Tax support, meanwhile, is positively correlated with future expected sales growth, but does not influence the likelihood of falling into arrears nor reducing the likelihood of insolvency. Payment deferrals of tax, seemed to be the least effective policy. [108]

4.3 Business environment measures introduced during the COVID 19 pandemic

The COVID 19 pandemic created both demand and a supply stress in LMIC, and provides interesting lessons regarding the effectiveness of different measures.[109] The World Bank has categorised COVID 19 pandemic responses for SME into i) debt finance, ii) employment support, iii) tax, iv) business costs, v) other finance, vi) demand, vii) business climate and viii) business advice measures. Figure 7 identifies how the 1,600 measures recorded, across countries, were split across categories.[110] Focus is given to lessons arising from debt finance, employment support, tax measures, business cost measures and business climate reforms hereunder.

The breadth of measures deployed across countries, was partly determined by the income level of countries. During the COVID 19 pandemic high-income countries employed supply and demand boosting components. LMIC found this more difficult due to informality and policy space. In Upper Middle-Income Countries, there was a greater emphasis on employment support and tax-based measures. In low and lower middle-income countries, where fiscal space was limited and the informal sector larger, there was a greater emphasis on debt finance.[111]

A broader range of measures to support SME were adopted in middle income case study countries, than in low-income countries. Figure 8 displays the incidence of recorded measures taken to support SME in case study countries. In Ethiopia, recorded measures consisted solely of a liquidity facility to private banks, though minor reforms were also made to the tax system. In Malaysia twelve measures were recorded in debt finance, five in employment support, two in other finance, two in income tax relief and one in business advice. No reforms were found in the business climate across countries, to include licensing and permitting and business closure or hibernation regulations.

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[108] Xavier, C, 2021, Policies to support businesses through the COVID 19 shock: A firm level perspective, online, available at: https://documents1.worldbank.org/curated/en/188461610547807479/pdf/Policies-to-Support-Businesses-through-the-COVID-19-Shock-A-Firm-Level-Perspective.pdf
[109] Ruch, F and T Taskin, Demand and supply shocks: Evidence from corporate earnings calls, World Bank Policy Research Working Paper: 9922
[110] This collation of measures has not been subjected to the World Bank's usual quality control measures.
[111] World Bank, 2024, Map of SME Support Measures in Response to COVID-19, online available at: https://www.worldbank.org/en/data/interactive/2020/04/14/map-of-sme-support-measures-in-response-to-covid-19

Figure 7: Business environment measures introduced during the COVID 19 pandemic, globally[112]

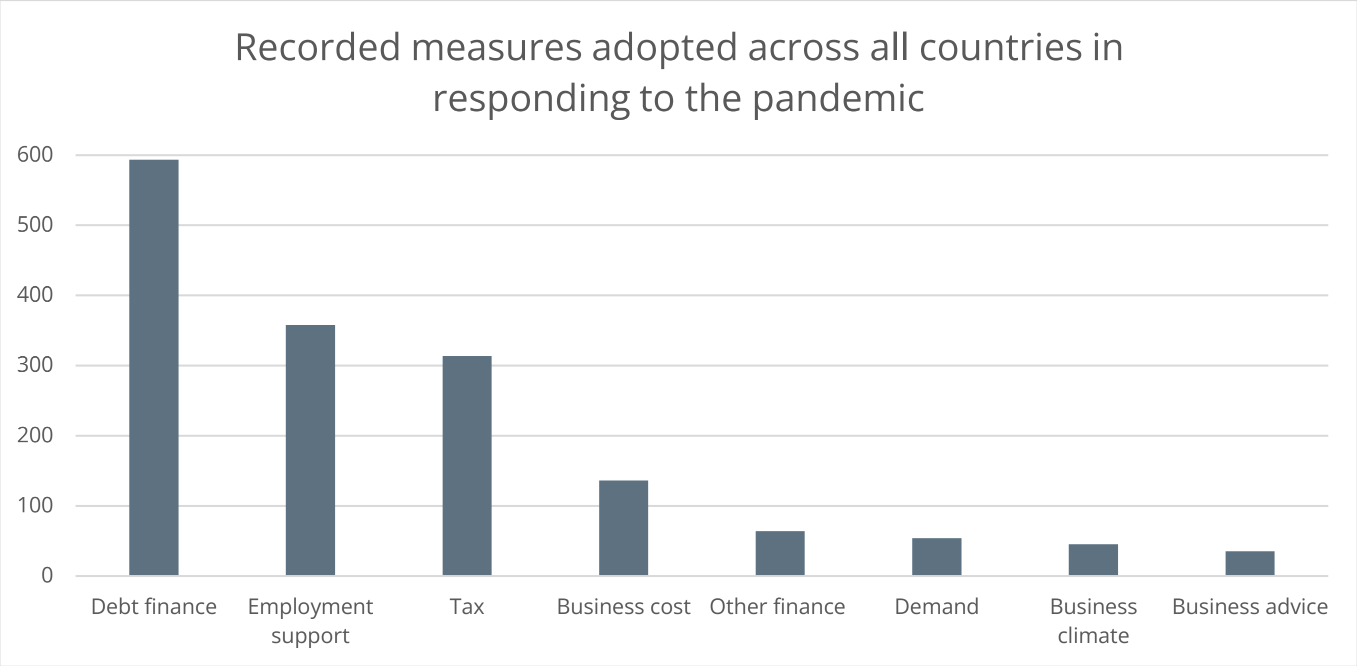
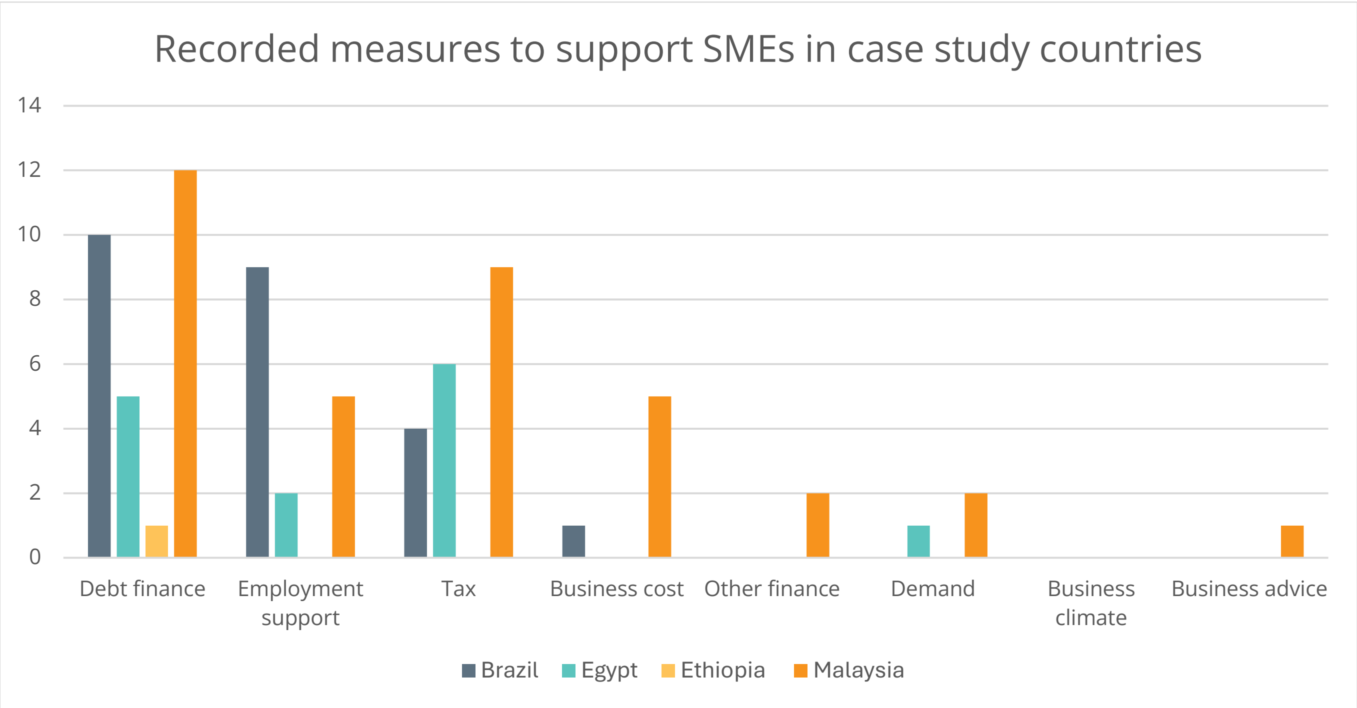


Figure 8: Measures taken to support SME in case study countries



[112] World Bank, 2024, Map of SME Support Measures in Response to COVID-19, online available at: https://www.worldbank.org/en/data/interactive/2020/04/14/map-of-sme-support-measures-in-response-to-covid-19

4.4 Relevance and (mis) targeting

The effectiveness of measures directly supporting MSME, is driven by how they are relevant to the needs of MSME and how efficiently they are delivered. Across 60 countries, Business Pulse Surveys demonstrated that the demand for policy support differed across country income groups, firm size, formality status, exporting status and transmission channels. Half of all businesses demanded access to finance (deferral of credit payments, suspension of interest payments, rollover of debt, new credit and loans with subsidised rates) and tax reductions and deferral measures.[113] Tax reductions and deferrals were more in demand in low-income countries, but also less possible because of fiscal space. Monetary transfers, payment deferrals and access to credit were in more demand in middle income countries. There was found to be a particular mismatch between the needs of businesses, and support provided, in payment deferrals and access to credit.

Governments have faced challenges in targeting support, to those MSME most in need. While some support measures were designed to be universal, and any firm could apply for support, there were instances of firms receiving support that did not need it. This mistargeting represents an inefficient expenditure and erodes fiscal space while undermining competition policy. Overall, businesses that experienced a sales (demand) stress were more able to get support, while a significant number who did not experience a drop in sales did receive support.

- 29% of firms experiencing demand and supply shocks received support.
- 20% of businesses received support that did not experience any stresses.

Mistargeting is partly explained by firm size, which drives access, and Government capability to target beneficiaries. Mistargeting was found to be more common in low-income countries. In certain countries where informality is widespread - it was difficult to reach out to certain segment of firms. In those contexts, preparing to, and implementing, the rapid expansion of social safety nets can allow for coverage of informal sector workers and entrepreneurs. Simply relying on existing systems that target the very poor will not be enough, as many who are not vulnerable under normal circumstances will become vulnerable during shocks. Many LMIC, expanded safety nets, horizontally and vertically, to support workers of informal and formal enterprises and their entrepreneurs. Despite their relevance, in low-income countries one in five of the world's poorest lack social safety net coverage.[114] This is a large area of study and is covered only lightly under employment support measures.

Women owned businesses were particularly hit by the COVID 19 pandemic but were less likely to receive support. Women led micro businesses, women led business in hospitality and women led businesses in severely affected countries resumed operations at a slower pace and reported larger declines in revenue.[115] Women led micro businesses and women led businesses in hospitality were more likely to grant employees leave or reduce their hours. While women led businesses were 2 percentage points less likely to access public support, compared to businesses led by men. Micro sized women led businesses were 4.4 percentage points less likely to receive public support than male led micro businesses. This gap reduced to 0.9 percentage points for businesses with more than 20 employees. Women led businesses in services, which was deeply affected, were less likely than male owned businesses to receive support.

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[113] Cirera, X, et al, 2021, Policies to support businesses through the COVID-19 shock, online, available at: https://documents1.worldbank.org/curated/en/188461610547807479/pdf/Policies-to-Support-Businesses-through-the-COVID-19-Shock-A-Firm-Level-Perspective.pdf
[114] World Bank, 2018, The State of Social Safety Nets, online, available at:
[115] Torres, J et al, 2021, The impact of the COVID 19 pandemic on women led businesses, online, available at: https://openknowledge.worldbank.org/server/api/core/bitstreams/3d46cd41-4f9a-5377-b396-bd5fdb78e2e7/content

4.5 Debt finance

Debt finance interventions were deployed in all case study countries. They were more in demand in middle income countries, where financial access is more prevalent.[116] Table 6 shows that Malaysia deployed the greatest number of debt finance interventions, followed by Brazil. Ethiopia, with constrained policy space, deployed one measure.

- + Debt finance is most appropriate during short term demand shocks, and only for formal businesses.
- + Debt financing will be more effective where firms have ready access to finance, women owned businesses face particular formal and informal constraints (collateral, information on financial products, transparency in application processes etc.) in access to finance.
- + Debt finance allows for the self-selection of firms or behaviours with desirable characteristics, such as viability- where loans are appropriately assessed.[117]
- - Debt finance is less appropriate during long term demand shocks and supply shocks.
- - Debt finance measures would not be available for informal businesses, and for businesses that face challenges in accessing finance.
- - Direct targeting with debt financing is challenging,
- - Debt finance can allow for viability to be considered by self-interested stakeholders, but data is often not available to do this accurately.[118] This is discussed in Section 6.
- - While MSME benefitted from low interest rates during the COVID 19 pandemic, the rapid increase in interest rates subsequently has resulted in burdens to MSME.
- - While guarantee schemes may have achieved short term benefits in terms of business survival, they may deliver longer term budgetary costs.

Table 8: Debt finance interventions deployed by country[119]

Country	Number of measures	Range of measures
Brazil	10	Capital buffers, credit guarantees, delayed repayments and new lending under concessional terms
Egypt	5	Delayed repayments, reduced interest rates, new lending under concessional terms
Ethiopia	1	New lending under concessional terms
Malaysia	12	Capital buffers, credit guarantees, delayed repayments, reduced interest rates, new lending, rapid approval/dispersal arrangements

[116] Cirera, X, et al, 2021, Policies to support businesses through the COVID-19 shock, online, available at: https://documents1.worldbank.org/curated/en/188461610547807479/pdf/Policies-to-Support-Businesses-through-the-COVID-19-Shock-A-Firm-Level-Perspective.pdf
[117] World Bank, Crisis and recovery: Learning from COVID 19's impacts and policy responses in East Asia, online, available at: https://www.worldbank.org/en/events/2023/07/11/crisis-and-recovery-learning-from-covid-19-s-economic-impact-and-policy-responses-in-east-asia-report-launch
[118] World Bank, 2021, Supporting firms in restructuring and recovery, online, available at: https://documents1.worldbank.org/curated/en/306401616131450724/pdf/Supporting-Firms-in-Restructuring-and-Recovery.pdf
[119] World Bank, 2024, Map of SME Support Measures in Response to COVID-19, online available at: https://www.worldbank.org/en/data/interactive/2020/04/14/map-of-sme-support-measures-in-response-to-covid-19

4.5.1 Debt finance in Brazil

Debt finance interventions were introduced in Brazil, largely through state owned banks. Among these, the Federal Savings Bank offered credit lines to SME aimed at working capital and the Bank of Brazil increased its credit lines, aimed at working capital investments and prepayment of receivables. The Emergency Credit Access Program provided guarantees, reduced interest rates and improved credit conditions for SME. Disbursements made to micro, small and medium sized enterprises, under this program, increased by 27% between 2019 and 2020.

Some innovative measures were made permanent. The National Program to Support Micro and Small Enterprises, an extraordinary credit line in the form of guarantees, was considered particularly effective. This became a permanent program in 2021. The program shared company registration numbers, gross revenue and capital stock, between the Federal Revenue of Brazil and financial institutions enrolled in the program, while providing similar information to small businesses.[120] By addressing information asymmetries, this allowed banks to identify businesses in need. But businesses still had to meet the requirements, and disbursement was apparently slow.

MSME sought debt finance to survive, and little consideration was given to long term debt commitments. Outstanding business loans to SME rose from BRL 533 billion in 2019 to BRL 938 billion in 2022, while the interest rates for SME fell from 24.6% in 2019, to 18% in 2021.[121] However, interest rates have since risen, and SME are now burdened with higher debt repayments. Despite these apparent benefits for SME, across Latin America micro enterprises (fewer than 5 employees) and informal firms were less aware of existing programs, less likely to apply for aid and less likely to receive aid. Concerns were also raised over the speed of loan disbursement. Meanwhile businesses that did receive aid (which were more likely to be formal and medium or large sized), reported better outcomes and expectations about the future.

4.5.2 Debt finance in Egypt

MSME were not deeply impacted by access to finance constraints during the COVID 19 pandemic. Enterprise Survey data suggest that firms in Egypt did not widely express financial concerns due to COVID, and the economy avoided a full lock down policy in 2020. The percentage of SME that considered access to finance as a very severe or major obstacle, reduced during the COVID 19.[122]

The Government of Egypt complemented lower interest rates with measures to delay repayments and stimulate new lending. Deferring repayments on loans to SME for six months, freed up cash flow to weather the immediate stresses. Egypt then focused measures on priority sectors, to support the recovery. Finance was directed towards the tourism sector, and the replacement and renovation of hotels. Meanwhile, EGP 100 billion was directed towards agricultural and construction companies, which is where GDP growth was focused during the COVID 19 pandemic.[123] Companies with non-performing loans were able to be removed from the non-performing loans list and have legal cases waived, if they paid off half of their debt. Only those with large cash reserves were able to do this. This was not a relevant measure, to those

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[120] OECD, 2022, Financing SMEs and Entrepreneurs 2022: An OECD Scorecard, online, available at: https://www.oecd-ilibrary.org/sites/91ccd722-en/index.html?itemId=/content/component/91ccd722-en

[121] OECD, 2024, Financing SMEs and Entrepreneurs 2024: An OECD Scorecard, online, available at: https://www.oecd-ilibrary.org/sites/835bcf1d-en/index.html?itemId=/content/component/835bcf1d-en

[122] Haider, J, How did Egypt soften the impact of COVID, in Shaping Africa's post COVID recovery, Centre for Economic Policy Research, online, available at: https://cepr.org/publications/books-and-reports/shaping-africas-post-covid-recovery

[123] CBE, 2022, Central Bank of Egypt's measures to offset the impact of COVID-19, online, available at: https://www.cbe.org.eg/-/media/project/cbe/file/long-context/central-bank-of-egypts-measures-to-offset-the-impact-of-covid19.pdf

businesses most in need. Despite the level of support in debt finance, the effectiveness of the response was impacted by mis targeting. This mistargeting has roots in Egypt's systems for state business relations. This is discussed further in Section 5.

4.5.3 Debt finance in Ethiopia

Ethiopia implemented a narrow range of debt finance measures. The Central Bank provided a liquidity facility of 0.45% of GDP to commercial banks, to facilitate debt restructuring and prevent bankruptcies within the banking system. A three-year liquidity line was provided to the Commercial Bank of Ethiopia.[124] A Business Sustainability and Job Protection Support program was initiated. This was to consist of an emergency phase and a recovery phase. Under this program, a loan facility was envisaged to support businesses with cash flow constraints. Donors were expected to mobilise finance for this initiative, but this did not eventuate. Many female entrepreneurs faced difficulties in accessing finance before the pandemic, and this and this was exacerbated during the pandemic as banks became cautious in lending.[125] The multi donor funded Women's Entrepreneurship Development Project sought to address this challenge, it offered incentives to financial institutions to extend grace periods, the maturity of loans and interest holidays.

The absence of fiscal space to fund debt finance, resulted in Ethiopia accessing a US$ 411 million emergency facility under the IMF's Rapid Financing Instrument. Ethiopia also benefitted from support under the Catastrophe Containment and Relief Trust.[126] Bilateral donors and non governmental organisations provided what support they could. The Master Card Foundation supported a Micro and Small Enterprise Resilience Facility (US$ 25 million), that was limited to Addis Ababa.[127]

4.5.4 Debt finance in Malaysia

Most MSME in Malaysia rely on informal sources of financing. However financial institutions play an important role in short term financing. SME were deeply affected during the COVID 19 pandemic, with 70% of SME recording a 50% drop in sales within the first week of the first Movement Control Order. Malaysia's second stimulus package included a RM 50 billion fund for working capital loan guarantees. A further six stimulus packages were announced with a multitude of debt finance measures.[128] In 2020, the total government allocation to support businesses in 2020 was MYR 117.8 billion. Key initiatives included:

- A MYR 5billion Special Relief Facility for SMEs at a reduced interest rate from 3.75% to 3.5%. Bank Negara Malaysia (BNM), subsequently upsized the SRF to MYR 10 billion due to overwhelming demand from SMEs;
- A MYR 6.8 billion All Economic Sector Facility to SMEs by the central bank with lowered interest rate from 8% to 7%; and,
- A six-month blanket loan repayment moratorium.

[124] IMF, 2022. Policy responses to COVID 19, online, available at: https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19#E
[125] Abebe, G, 2020, The impacts of COVID-19 on women owned enterprises in Ethiopia: Findings from a high frequency survey, online, available at: https://openknowledge.worldbank.org/entities/publication/4e0feb61-1b2f-508d-a16a-f3424b3acf86
[126] IMF, 2020, IMF Executive Board Approves US$ 411 in emergency assistance, online, available at: https://www.imf.org/en/News/Articles/2020/04/30/pr20199-ethiopia-imf-executive-board-approves-emergency-assistance-to-address-the-covid-19-pandemic
[127] UNCTAD, 2021, The macro-economic and social impact of COVID 19 in Ethiopia in the Global Context, UNCTAD Research Paper no. 75
[128] ILO, 2023, COVID 19 country policy responses, online, available at: https://www.ilo.org/global/topics/coronavirus/regional-country/country-responses/lang--en/index.htm

SME lending rapidly increased during the COVID 19 pandemic. Malaysia's debt financing efforts, saw outstanding SME loans increasing by 9.6% in 2020, and the share of SME lending increased to 45% in 2020 from 41% in 2019.[129] Because SME use financial institutions for short term financing, debt financing became an important part of Malaysia's response. The impact of the COVID 10 pandemic on non-performing loans became apparent in 2022, as the loan repayment moratorium came to an end and interest rates rose. [130] Malaysia's effort in debt finance allowed more productive firms to self-select behaviours, such as taking out loans, or incentivizing investments that will contribute to increased productivity in the future, such as technology adoption and innovation.[131]

Women entrepreneurs in Southeast Asia suffered disproportionate impact from the COVID 19 pandemic. Operating in the most vulnerable sectors and bearing the brunt of childcare responsibilities, pre-existing gender disparities in financial services, technology usage and training were exacerbated.[132] The International Labour Organisation's Rebuilding Better project aimed for small women owned businesses to stabilise and recover from COVID, while adopting more sustainable and resilient business models.

Recommendations

- Consider utilising debt finance measures during short term demand shocks, supply shocks and natural disasters
- In preparing for shocks, address information asymmetries- through establishing processes to share information between registered regulators, SME and financiers
- During emergency phase, allow for concessional long-term interest rates
- Consider the future impact of guarantee schemes on public budgets
- Consider establishing mechanisms to assess future solvency and current viability, in loan approval considerations
- Consider targeting concessional finance to stimulate investment and innovation during the recovery phase
- Consider complementing debt finance interventions, with the expansion of social safety nets to support entrepreneurs of small businesses and the self employed

4.6 Employment support

Employment support measures consisted of wage subsidies, tax credits and loans. All countries funded employment support interventions, apart from Ethiopia. Here, donors, provided support to employment retention. Brazil deployed nine measures, Malaysia five measures and Egypt two measures. Table 10 details the measures by country.

[129] OECD, 2022, Financing SMEs and entrepreneurs 2022: An OECD scorecard, online, available at: https://www.oecd-ilibrary.org/sites/3bc2915c-en/index.html?itemId=/content/component/3bc2915c-en#section-d1e182419
[130] World Bank, 2022, Malaysian SME program efficiency review, online, available at: https://documents1.worldbank.org/curated/en/099255003152238688/pdf/P17014606709a70f50856d0799328fb7040.pdf
[131] World Bank, 2023, Crisis and recovery: Learning from COVID 19's impact and policy response in East Asia, online, available at: https://www.worldbank.org/en/events/2023/07/11/crisis-and-recovery-learning-from-covid-19-s-economic-impact-and-policy-responses-in-east-asia-report-launch
[132] ILO, 2022, Rebuilding Better: Fostering Business Resilience Post Covid 19, online, available at: https://www.ilo.org/projects-and-partnerships/projects/rebuilding-better-fostering-business-resilience-post-covid-19

Employment support measures were more in demand in middle income countries, than low-income countries. Wage subsidies were most common in high income countries.[133] We focus on wage subsidies hereunder. During a demand shock, wage subsidies are justified by i) the shadow price of labour being lower than prevailing wages and ii) externalities associated with higher unemployment. These measures have the objective of maintaining and continuing the employment relationship, an objective that is beneficial to both workers and enterprises.

+ Wage subsidies could only be directed towards formal businesses, with registered workers.
+ Wage subsidies are most relevant to short term demand shocks, and natural resource shocks.
+ Wage subsidies are in particular demand in middle income countries, were informality is lowe.
+ Wage subsidies can be particularly effective during economic recovery, to tilt the incentives of firms towards restarting.[134]
- Wage subsidies will be less effective in countering supply shocks and long-term demand shocks.[135]
- Wage subsidies would not reach informal enterprises, nor their entrepreneurs or workers. Social safety nets must be expanded efficiently, vertically and horizontally, to provide support to these workers.
- Wage subsidies, used in isolation, can encourage employment retention, at the expense of the efficient reallocation of labour.

Table 9: Employment support measures deployed by country[136]

Country	Number of measures	Range of measures
Brazil	9	Wage subsidies, support for informal workers, new working schemes
Egypt	2	Support for informal workers
Ethiopia		
Malaysia	5	Wage subsidies, new working schemes, support to informal workers

In addition to wage subsidies, there is also scope to consider work time arrangements, reskilling and upskilling and other social protection measures. Work time measures can include work sharing, the reduction of working hours without wage compensation and the use of obligatory holidays. Rapid skills assessments meanwhile can assist businesses in responding to emerging skills needs, in consultation with education and skills training institutions.[137]

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[133] World Bank 2021, Jobs watch COVID 19: Exploring two years of labor market policy responses to COVID 19- a global effort to protect workers and jobs, online, available, at: https://documents.worldbank.org/en/publication/documents-reports/documentdetail/736581626933374446/jobs-watch-covid-19-the-evolving-labor-market-impacts-of-covid-19-in-developing-countries
[134] Blanchard, O, 2020, A new policy toolkit is needed as countries exit COVID lockdown, Petersen Institute for International Economic Policy Brief no. 20-8
[135] ILO, 2020, Temporary wage subsidies, online, available at: https://webapps.ilo.org/wcmsp5/groups/public/---ed_protect/---protrav/---travail/documents/publication/wcms_745666.pdf
[136] World Bank, 2024, Map of SME Support Measures in Response to COVID-19, online available at: https://www.worldbank.org/en/data/interactive/2020/04/14/map-of-sme-support-measures-in-response-to-covid-19
[137] ILO, 2021, A framework to support small firms in developing countries navigate crisis and build resilience, online, available at: https://www.ilo.org/sites/default/files/wcmsp5/groups/public/%40ed_emp/%40emp_ent/%40ifp_seed/documents/publication/wcms_831842.pdf

Women faced deep challenges from employment during the COVID 19 pandemic. Because of pre-existing gender equalities, women tend to hold less secure jobs. The labour force participation rate for women reduced, as women took on even more unpaid household work and childcare. Specific measures for women could include enhanced social protection, through paid leave and cash transfers. Supporting women's employment in crisis and recovery could be furthered through enhancing the availability and affordability of care services, flexible work arrangements and access to paid family leave.

4.6.1 Employment support in Brazil

Informal, younger, workers were disproportionately affected by layoffs. In April 2020, over 860,000 jobs were lost, with unemployment benefit applications reaching 960,000 in May - an increase of 53% compared to the previous year.[138] The reduction disproportionately affected informal workers, women and younger workers. Older workers were more likely to retain their employment, with high reductions in working hours. Brazil implemented temporary compensation for furloughed workers who were registered and have a work and social security card, to avoid mass layoffs and maintain the employment relationship. This covered around 25% of formal private workers and played an important role in protecting formal employment.[139]

Social safety nets were adapted to address income shocks among informal workers. Due to high levels of informality many micro and small businesses could not apply to the furlough scheme. To address this, access to social transfers system were expanded through the Bolsa Familia programs and Auxilial Emergencial. The latter covered formal and informal self-employed workers. Double benefits were provided to families headed by women.[140] The case of Brazil shows that countries that already have solid social safety net programs and institutions in place are more resilient - as measures can be more easily and quickly deployed.

Wage subsidy programmes could have better contributed to the recovery. Brazil has previously implemented wage subsidy programmes, with limited cost effectiveness.[141] Prior to the COVID 19 pandemic the Contrato Verde Amarelo programme was designed, but not implemented, as a subsidy for young labour market entrants. The recovery from the COVID 19 pandemic was slow, and there was pressure to continue subsidising wages. In this context, targeted wage subsidies to the private sector, such as Contrato Verde Amarelo, had a role to play, as they could have fulfilled the objective of supporting firms' recovery, in a more equitable and less costly way than alternatives.

Further measures could have supported the reallocation of labour and the economic recovery. The creation of labour reallocation mechanisms, such as professional training and incentives for job searches during the paid time off from work, could have further complemented economic recovery and a reduction of public spending. Existing public sector supported apprenticeship schemes could also be reformed and updated, for a more efficient reallocation of labour following future shocks.

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[138] World Bank, 2020, How to support MSMEs so they overcome the COVD 19 shock, online, available at: https://www.worldbank.org/en/news/opinion/2020/07/10/brazil-how-support-micro-small-medium-enterprises-overcome-covid-19-coronavirus-shock
[139] IMF, 2021, The short term impact of COVID-19 on labor markets, poverty and inequality in Brazil, online, available at: https://www.imf.org/en/Publications/WP/Issues/2021/03/05/The-Short-Term-Impact-of-COVID-19-on-Labor-Markets-Poverty-and-Inequality-in-Brazil-50124
[140] IMF, 2021, Gender equality and COVID 19:Policies and institutions for mitigating crisis, online, available at: https://www.imf.org/-/media/Files/Publications/covid19-special-notes/en-special-series-on-covid-19-gender-equality-and-covid-19.ashx
[141] World Bank, 2020, Contrato Verde Amarelo: An initial assessment, online, available at: https://openknowledge.worldbank.org/server/api/core/bitstreams/50bc7fe5-38f6-5c56-ab3a-9e2b2876e78e/content

4.6.2 Employment support in Egypt

Egypt has a high share of informal employment. Before the COVID 19 pandemic, labour force participation rates were declining and informality rates increasing. The share of Egyptians in employment fell by 8% between February and June 2020. 21% of formal employees reported wage losses, while two thirds of informal workers suffered wage losses.[142]

Reforms were made to support formal sector workers. Egypt established the Employees Emergency Fund in 2002. It was established to provide financial aid and subsidies to employees who have not received salaries from companies facing the risk of (total or partial) closure due to economic crisis or a decline in production. In March 2020, a Special Committee was established to ensure the efficiency of disbursements under the Fund to effected workers. The Fund provided employees of approved companies financial aid equivalent to 100% of their basic insurance salary. This was extended beyond the initial window of six months. By June 2021, this had covered 416,660 workers in 3,824 businesses. Egypt's case demonstrates the value of having funds already established, that can respond to mass layoffs during crises.

Social safety nets were also adapted, to support informal workers. Due to the high levels of informality, this was complemented by expansions to the Takaful and Karama cash transfer programs. These programs reached 3.8 mlln. households, they were mainly targeted at female headed households.[143] This was partly done by utilising waiting lists, while using revisions of the proxy means test thresholds to assess eligibility. For cash and in-kind assistance, households were identified from the databases to identify elderly people, persons with disabilities and female headed households who would receive benefit.[144] Simulations showed that without cash transfers poverty rates would have reached 31%; compared to 28% under the cash transfer programs.[145]

Reforms to employment support programmes did not reverse labour market outcomes. Despite the wage subsidy program, deteriorating labour market trends continued after the COVID 19 pandemic.[146] Jobs were saved, and this supported businesses. However, in the absence of labour market reforms and major reforms to boost private sector development, high unemployment and informality will remain. This will constrain Egypt's ability to benefit from the demographic dividend.

4.6.3 Employment support in Ethiopia

Employment losses, including reduced hours, were particularly prevalent in urban areas. The COVID-19 had significant adverse effects on employment in Ethiopia. Urban areas were particularly severely affected, with 20% of urban respondents losing their job by April 2020, 64% of whom attributed their job loss to

[142] ILO, 2021, The impact of COVID 19 on employment and wages in Egypt, online, available at: https://webapps.ilo.org/wcmsp5/groups/public/---africa/---ro-abidjan/---sro-cairo/documents/publication/wcms_791076.pdf
[143] IMF, 2021, Gender equality and COVID 19:Policies and institutions for mitigating crisis, online, available at: https://www.imf.org/-/media/Files/Publications/covid19-special-notes/en-special-series-on-covid-19-gender-equality-and-covid-19.ashx
[144] UNICEF, 2022, Social Protection Responses to COVID 19 in MENA: Design, Implementation and Child Safety, online, available at: https://www.unicef.org/mena/media/19356/file/Research%20Report%20N°%2078.pdf
[145] IFPRI, 2020, COVID 19 and Social Protection: From Effective Crisis Protection to Self Reliance, online, available at: https://egyptssp.ifpri.info/2020/10/05/covid-19-and-social-protection-from-effective-crisis-protection-to-self-reliance/
[146] World Bank, 2023, Egypt's labour markets and the COVID 19 pandemic- a longer term perspective, online, available at: https://thedocs.worldbank.org/en/doc/5bd1e246a8fcba06ace05e7bb3c3813f-0280032023/original/Egypt-COVID-LM-Jul2023.pdf

COVID-19.[147] In the Hawassa Industrial Park, 41% of respondents employed in January 2020 were either put on leave or losing their job by the time of the survey in the spring and summer of 2020.

Wage subsidy initiatives were limited in breadth. Wage subsidies were anticipated to safeguard some employment.[148] Ethiopia's Job Creation Commission implemented a scheme to support industrial jobs. [149] The Ethiopian Jobs Protection Facility was backed by the United Kingdom and Germany and focused on the industrial parks. This was very limited in scope, with a third of firms in industrial parks received some support, whereas outside industrial parks just about 0.5% of firms had received some support. A similar, small scale, initiative was implemented by the United Nations Development Program.

Social safety nets were adapted, but effectiveness was constrained by finance and the uniqueness of the stresses. The Productive Safety Net Programme, protected household food security in rural and urban areas. An evaluation found that the programme offset virtually all adverse COVID 19 pandemic related impacts for participating households. However, the protective role of the programme was higher in poorer households and those living in remote areas.[150] This indicates the value in having social protection programmes in place prior to the onset of shocks, that can be expanded or scaled. However, a major constraint in providing a more extensive social protection response was the lack of available finance.[151] There were also challenges with targeting, as the case load affected by COVID was different from the routine case load which is linked to food insecurity and droughts. Experience from Ethiopia suggests that social safety nets should be ready to be expanded efficiently, this includes taking effort to improve targeting given the increasingly varying nature of shocks.

4.6.4 Employment support in Malaysia

Movement Control Orders and demand stresses resulted in rapid job losses. From the start of the COVID 19 pandemic to September 2021, 150,000 SME shut resulting in 1.2 million job losses. In the first package of support, wage subsidies of RM 600 were provided to workers earning below 4,000 ringit per month and where business income has halved. In May 2020, under the Penjana package this was extended. In September 2020 this was extended again, for businesses experiencing a drop in revenues of 30%.[152] In 2021, longer subsidy arrangements were available for new businesses in tourism and retail.

Only formal businesses could access wage subsidies, and social safety nets were strengthened to capture informal workers and those that became unemployed. Wage subsidies were stated to have

[147] BRE, 2021, The impact of COVID 19 in Ethiopia: Policy brief, online, available at: https://www.opml.co.uk/files/Publications/a2422-building-resilience-ethiopia/policy-brief-04-11-21-final.pdf?noredirect=1#:~:text=Many%20respondents%20across%20the%20studies,in%20the%20ready%2Dmade%20garment
[148] World Bank, 2021, The impact of COVID 19 on formal firms: Evidence from Ethiopia, online, available at: https://documents1.worldbank.org/curated/en/212611598012154194/pdf/The-Impact-of-COVID-19-on-Formal-Firms-Evidence-from-Ethiopia.pdf
[149] UNCTAD, 2022, Ethiopia's response to the COVID 19 pandemic: Measures, impacts and lessons, online, available at: https://unctad.org/system/files/official-document/BRI-Project_RP25_en.pdf
[150] Abak, K, 2023, COVID 19 and Food Security in Ethiopia: Do Social Protection Programmes Protect? Economic Development and Cultural Change, online, available at: https://www.journals.uchicago.edu/doi/epdfplus/10.1086/715831
[151] MAINTAINS, 2021, Towards Shock Responsive Social Protection: Lessons from COVID 19 Response in Ethiopia, online, available at: https://www.opml.co.uk/files/Publications/A2241-maintains/maintains-covid-19-srsp-responses-ethiopia-country-case-study-final.pdf
[152] UNDP, 2023, The onset of a pandemic: Impact assessments and policy responses in Malaysia during the earling months of COVID 19, online, available at: https://www.undp.org/publications/onset-pandemic-impact-assessments-and-policy-responses-malaysia-during-early-months-covid-19

saved 2.96 million jobs between April 2020 and November 2022.[153] Access to wage subsidies were associated with an 8% lower likelihood that a firm laid off workers.[154] In April 2020, business associations advocated for extensions to the wage subsidy program, to all employees regardless of their income level.

Sequencing support to employment could have been more effective. Reorienting support away from employment retention and toward measures that support employment activation could have been timed more appropriately. Given the potential of the COVID 19 pandemic to exacerbate skills mismatches. Hiring incentives also require better balance with well-designed and well-targeted training programs. Firms that received hiring incentives, were also significantly more likely to have hired new workers during the recovery.

Recommendations

- Governments in LMIC should consider utilising, and donors supporting, wage subsidies during short demand shocks and natural disasters, where fiscal policy space allows
- Governments in LMIC should consider utilising, and donors supporting, wage subsidies during emergency phases, and then transition to retraining and hiring incentives during the recovery phases to efficiently reallocate labour
- Governments in LMIC should consider preparing to implement new work time arrangements during particularly acute shocks`
- Prepare to complement wage subsidies with differing vertical and horizontal expansions of social safety nets, to support entrepreneurs and workers of informal businesses and the self-employed during different types of stresses

4.7 Tax measures

All countries deployed tax measures.[155] Tax measures were particularly in demand in lower income countries, where access to finance is limited. Tax measures were less likely to be deployed in these countries, however.[156] Ethiopia deployed tax measures, that were limited in scope. Tax measures could not reach those unregistered for tax.

+ Tax measures are relevant to short term demand shocks and natural disasters and can assist with managing liquidity in formal firms.
+ Tax measures can use financial information to target tax relief.
+ Tax relief measures can be rapidly designed and deployed.
+ Consider the implementation of tax measures in low-income countries, where access to finance is constrained.
+ Tax based measures can allow for an immediate response, and in supporting building back better through incentivising investment and innovation.
- Tax measures are less relevant to long term demand shocks and supply shocks.
- Tax measures will not reach informal MSME.
- Corporate tax deferrals only assist those firms that make a profit,

[153] MoF, 2022, Press citations, online available at: https://www.mof.gov.my/portal/en/news/press-citations/govt-channels-rm20-92-bln-to-wage-subsidy-programme-tengku-zafrul#:~:text=92%20bln%20to%20wage%20subsidy%20programme%20–%20Tengku%20Zafrul,-Press%20Citations%2004&text=KUALA%20LUMPUR%2C%20Aug%204%20(Bernama,unemployment%20rate%20in%20the%20country.
[154] World Bank, Crisis and recovery: Learning from COVID 19's economic impacts and policy responses in East Asia, online. Available at: https://www.worldbank.org/en/events/2023/07/11/crisis-and-recovery-learning-from-covid-19-s-economic-impact-and-policy-responses-in-east-asia-report-launch
[155] The World Bank's database of measures, did not cover the use of tax subsidies in Ethiopia. These were narrow in scope.
[156] Cirera, X, et al, 2021, Policies to support businesses through the COVID-19 shock, online, available at: https://documents1.worldbank.org/curated/en/188461610547807479/pdf/Policies-to-Support-Businesses-through-the-COVID-19-Shock-A-Firm-Level-Perspective.pdf

- The common requirement for two years' worth of past information reduces the efficiency of this measure, as solvency and viability changes rapidly during crises.
- There is evidence of the mistargeting of tax measures in case study countries and not using the financial information that is available.

A range of tax reforms were implemented, but this differed across countries. LMIC used administrative measures, such as tax filing and payment extensions, accelerated repayments and structured debt repayment plans. The primary motivation among reforms to presumptive tax regimes in middle income countries, was to reduce compliance costs of entering the formal economy.[157] In the recovery phase, there was space to deploy accelerated depreciation, research and development incentives and investment credits. Table 11 shows that only Malaysia implemented these measures. Special tax exemptions for MSME were recommended to be avoided during the recovery, to encourage firm growth.[158]

Table 10: Tax measures deployed by country[159]

Country	Number of measures	Range of measures
Brazil	4	Deferral of corporate tax (3 months for SME regime), payroll deferrals
Egypt	6	Capital gains, tax on dividends, stamp duty reduction
Ethiopia	0	
Malaysia	9	Deferral of income tax for SME, special relief for tourism, hotel service tax exemption, incentives to angel investors and capital expenditure, reform to payments to Employees Provident Fund

4.7.1 Tax measures in Brazil

Brazil implemented a range of measures under its War Budget. This allowed for expenditures beyond the constitutional barriers that restrict fiscal spending. Among these, debt statements with the federal government were postponed for three months to provide liquidity to businesses, deferrals were made to the Length of Service Guarantee Fund for four months and contributions to the public health fund were reduced by 50%. The special tax regime for smaller businesses deferred payments for three months. Brazil did not implement tax measures to support innovation during the recovery, such as economy wide or sector specific incentives to investment.

4.7.2 Tax measures in Egypt

Egypt implemented stamp duty and taxes on dividends reforms. Sector specific initiatives included real estate tax relief for tourism and industry, and a moratorium on tax law for agricultural land for two years. Deferrals and wide-ranging tax reductions were not implemented. Egypt did not implement measures to support innovation during the recovery, such as economy wide incentives to investment.

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[157] OECD, 2023, Tax reforms in low and middle income countries, online, available at: https://www.oecd.org/tax/tax-policy/tax-policy-reforms-in-low-and-middle-income-countries-policy-brief.pdf
[158] IMF, 2020, Tax policy for inclusive growth after the pandemic, online, available at: https://www.imf.org/-/media/Files/Publications/covid19-special-notes/en-special-series-on-covid-19-tax-policy-for-inclusive-growth-after-the-pandemic.ashx
[159] World Bank, 2024, Map of SME Support Measures in Response to COVID-19, online available at: https://www.worldbank.org/en/data/interactive/2020/04/14/map-of-sme-support-measures-in-response-to-covid-19

4.7.3 Tax measures in Ethiopia

In Ethiopia a range of tax debt, interest and penalty measures were announced. Sub national administrations introduced their own measures for small businesses and sole proprietors. For example, the Addis Ababa City Administration offered a tax credit that was equal to 25 per cent of the annual tax liability of the taxpayers. Extensions were also made to filing and payment deadlines. Measures to stimulate the recovery were not implemented.

Despite being delivered rapidly, design issues hampered effectiveness. These tax measures came into force within a month of their announcement. However, the tax amnesty was not targeted. The only criteria was the non-payment of past debts. Taxpayers that had paid their tax on time, received no benefit.[160] Benefits were not available to firms in need, who had complied with their tax obligations. Ethiopia' case suggests that tax-based measures could be better targeted.

4.7.4 Tax measures in Malaysia

Malaysia sequenced tax measures to manage the immediate impact of stresses, and support the recovery. Malaysia introduced a wide range of tax measures to weather the immediate impact of the COVID 19 pandemic and to support SME in recovering.[161] This phasing of the response, under eight stimulus packages makes Malaysia's case unique. In the early phases, measures included income tax deferrals for SME. These were complemented by sector specific measures in tourism and incentives to investment, to encourage investment in the recovery. Special incentives were also available to foreign manufacturers that undertook an investment in Malaysia.

Short term relief measures, such as access to tax deferrals and wage subsidies, are easy to implement and useful in preventing widespread employment losses, but they are prone to mistargeting and the misallocation of resources. Corporate income tax deferrals, for example, affect only firms with profits. In Malaysia, tax deferral served to favour larger firms and was not correlated with revenue loss. In pursuit of improved targeting, tax deferral seems unsuited to the task.

Recommendations

- Consider utilising tax measures during short term demand shocks and natural disasters
- Prepare to expand the use of tax measures, in low-income countries where access to finance in constrained
- During short term demand shocks and natural disasters, prepare to allow MSME to defer tax payments
- Prepare to implement simplified quarterly accounting practices, to enable the targeting of tax measures to those most in need
- Avoid deploying measures that only benefit those that are in arrears in their tax payments
- Prepare to deploy accelerated depreciation, research and development incentives and investment credits during the recovery phases

[160] ICTD, 2023, The tax response to COVID 19 in Ethiopia: Lessons for the future, online, available at: https://elibrary.acbfpact.org/acbf/collect/acbf/index/assoc/HASH1647/2c206577/156b9b02/8e.dir/African%20Tax%20Administration%20Paper.pdf

[161] IMF 2023. Policy responses to COVID 19, online, available at: https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19#E

4.8 Business cost measures

Only Malaysia and Brazil deployed measures to reduce business costs. Malaysia deployed five measures, and Brazil one measure (though this was related to employment support). This section focuses on energy price subsidies, given the relevance of energy prices to a range of demand and supply stresses and the recent spike in energy prices.

Table 11: Business costs measures deployed by country[162]

Country	Number of measures	
Brazil	1	Firms can reduce working hours by 50%, no compensation for employees
Egypt		
Ethiopia		
Malaysia	5	Waiver for credit reference checks, tax reductions for landlords who rent to SME, sector specific electricity tariff reductions

Universal subsidies can deliver benefits for businesses. However, their sudden and wholesale removal can negatively affect businesses. Given this, there is a need to understand whom existing or planned subsidies benefit, and how, and who stands to be effected by implementing, reforming or removing them.

Blanket pricing subsidies can lead to unintended, sometimes longer term, consequences. The IMF suggests that pricing subsidies not be deployed to counter economic shocks. After declining to 2020, energy subsidies rebounded during the COVID 19 pandemic and recent energy price shocks. While politically attractive during times of energy price shocks, subsidies have distributional and longer-term consequences. Evidence suggests that energy subsidies almost always benefit the richer, they incentivise the consumption and production of fossil fuels, the send misleading signals of the true cost of energy, they have a significant fiscal impact and they counter climate change mitigation tools.[163] Given this, there is a need for subsidies, when used, to be time bound, transparent and fully budgeted. Fossil fuel subsidies also serve to disincentivise a green recovery from shocks, which has increasing focus from policy makers.

Indiscriminate subsidies are among the least efficient ways to deal with energy price shocks. Further, agreements, at Conference of Parties of the United Nations Framework Agreement on Climate Change, have also been made to eliminate indiscriminate subsidies. Energy price responses should instead target the most vulnerable MSMEs.

Energy subsidies can be targeted towards certain categories of businesses. In Malaysia, smaller firms and those in services benefited more from pricing subsidies. Evidence shows that 33% of small firms and 13% of medium sized firms benefited from discounts on electricity bills. This benefited non-manufacturing firms,

[162] World Bank, 2024, Map of SME Support Measures in Response to COVID-19, online available at: https://www.worldbank.org/en/data/interactive/2020/04/14/map-of-sme-support-measures-in-response-to-covid-19
[163] 2022, World Bank, Amid energy price shocks, five lessons to remember on energy subsidies, Sustainable Energy for All, online, available at: https://blogs.worldbank.org/en/energy/amid-energy-price-shocks-five-lessons-remember-energy-subsidies

more than manufacturing firms. These subsidies almost met the preferences of businesses, with 46% of small firms and 24% of medium firms preferring lower costs for utilities.[164]

Recommendations

- LMIC should consider utilising energy subsidies sparingly
- LMIC should design mechanisms to target support to the most vulnerable MSMEs during shocks
- To further a green recovery, LMIC could consider incentivising:
  - Clean physical infrastructure investment;
  - Building efficiency retrofits;
  - Investment in educating and training a green workforce
  - Natural capital investment for ecosystem resilience; and,
  - Enhanced rural spending.

4.9 Regulatory flexibility

Shocks provide opportunity to enable business dynamism. Taking advantage of this, requires support measures to be designed towards the specific needs of MSME segments, while allowing for access by smaller firms. Firm closure increased during the initial phases of the COVID 19 pandemic but then rebounded rapidly during the recovery.[165] This surge in business dynamism provided opportunity to foster resource allocation; through lowering the cost and time associated with business entry and exit.[166] It allows for preparation for future shocks, while accelerating the process of structural change through enabling business dynamism. Enabling efficient business closure during the emergency phase, and then efficient business opening during the recovery phase, can support this endeavour. No case study countries supported business entry, hibernation or exit reforms.

In some advanced economies, Governments helped businesses through greater regulatory flexibility. This was most common in temporary amendments to insolvency frameworks.[167] Regulatory flexibility can support firm resilience. In the initial stages of a shock, introducing extraordinary time bound adjustments to insolvency frameworks, can stop viable firms being pushed into bankruptcy. Measures could include raising the debt threshold for credit-initiated bankruptcy proceedings, suspending directors' duty to file for bankruptcy and suspending the personal liability of directors. Similar flexibility could have relevance to business opening processes. This could include risk-based approaches to licensing and permitting, to lower enforcement and compliance costs. Any flexibility in regulations, should not be at the price of public policy outcomes.

Regulations that allow MSME hibernation, will further resilience. Many small firms may need to enter hibernation during shocks. Creating a legal framework through which small firms can enter hibernation, with protection from financing, tax and selected fix costs could help them survive a shock. Progressing this would

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[164] UNIDO, Impact assessment of COVID 19 on Malaysia's manufacturing firms, online, available at: https://www.unido.org/sites/default/files/files/2021-03/UNIDO%20COVID19%20Assessment_Malaysia_FINAL.pdf

[166] OECD, 2020, Business dynamism during COVID 19 pandemic: Which policies for an inclusive recovery, online. Available at: https://www.oecd.org/coronavirus/policy-responses/business-dynamism-during-the-covid-19-pandemic-which-policies-for-an-inclusive-recovery-f08af011/

[167] DCED, 2021, Using business regulations in re-opening the economy following the COVID 19 pandemic, online available at: https://www.enterprise-development.org/wp-content/uploads/DCED-BER-Covid-Policy-Brief-1-Business-regulation-final-26APR21.pdf

entail i) creating an emergency regulation option for small businesses to temporarily stop activities and ii) setting a minimum cash level for hibernation. [168]

During the COVID 19 pandemic, regulatory flexibility in LMIC centred on trade related regulations. This aimed to secure cross border value chains and reduce demand and supply stresses. Reduced customs duties were most prevalent, followed by streamlined customs procedures and the elimination of import licensing.[169] Donors supported the digitalisation of customs and movements to a single window, which reduced the costs of trade. In the Philippines, this led to a reduction in the time to import by 43%.[170] In many countries, streamlined processes were introduced for priority imports, associated with medical equipment related to the COVID 19 pandemic.

Recommendations

- Authorities in LMIC should prepare to adopt, with donor support, business closure reforms during shocks, and risk-based approaches to business opening during the recovery phase- this should occur alongside ongoing effort to lower the burden of regulatory compliance while protecting public policy outcomes
- Authorities should establish, with support from donors, regulatory frameworks to enable MSME to enter into hibernation during short term shocks
- Authorities in LMIC should prepare to implement measures, with donor support, to allow for regulatory flexibility, particularly in trade regulations, during shocks

[168] ILO, 2023, A framework to support small firms in developing countries navigate crises and build resilience, online, available at: https://www.ilo.org/publications/framework-support-small-firms-developing-countries-navigate-crises-and#:~:text=Report-,A%20framework%20to%20support%20small%20firms%20in%20developing%20countries%20navigate,small%20firms%20during%20such%20conditions.
[169] OECD, 2023, Regulatory flexibility, online, available at: https://www.oecd.org/trade/resilient-supply-chains/regulatory-flexibility/#:~:text=Regulatory%20flexibility%20does%20not%20mean,or%20services%20can%20be%20accelerated.
[170] UK Gov, 2023, Prosperity Fund programme completion review, online, available at: https://assets.publishing.service.gov.uk/media/63597f03d3bf7f0bcd254c89/Prosperity-Fund-Programme-Completion-Review.odt

5. Under which institutional conditions can business and investment climate reforms aimed at resilience be successfully implemented at the macroeconomic level?

Institutional conditions are key for resilience among MSME during shocks. Much of the literature on exogenous shocks in LMIC, focuses on the drivers of shocks and responses to manage the immediate impact and recover. Issues of political economy have at times been overlooked.

Institutions establish the rules of the game for authorities in LMIC, and formal and informal MSME. Institutions define the formal and informal constraints on political, economic and social interactions.[171] Responses by Governments show that formal rules can change rapidly during exogenous shocks. Informal norms change much more slowly in normal times, but shocks do provide space for the more rapid adaptation of informal norms, to the benefit of MSME. These adaptations can improve the promotion of efficient and effective responses to shocks, through a greater consideration of the needs and expectations of MSME. More effective institutions can then also define organisational norms, procedural devices and regulatory frameworks. Governments may be more willing to consider reforms, such as those in gender equality and the informal sector, as a result of public pressure arising from acute exogenous shocks.

Institutions explain a substantial difference in GDP per capita and GDP growth.[172] Statistical analyses suggest that an improvement in institutional quality, reduces the volatility of growth.[173] In turn, this can bolster the sustainability of gains in inclusive development.

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[171] North, D, 1991, Institutions, ideology and economic performance, Cato Journal, online, available at: https://heinonline.org/HOL/LandingPage?handle=hein.journals/catoj11&div=47&id=&page=
[172] Easterly W, and R Levine, Tropics, germs and crops: How endowments influence economic development, Journal of Monetary Economics, vol. 50, no. 1
[173] IMF, 2003 Growth and institutions, online, available at: https://www.imf.org/-/media/Websites/IMF/imported-flagship-issues/external/pubs/ft/weo/2003/01/pdf/_chapter3pdf.ashx

5.1 Context matters

There is no one size fits all policy recipe, that can be suitable for a LMIC in navigating a specific shock.[174] Country specificities, require economic policy making to be tailored to local contexts during shocks. This is much more difficult than simply picking the most relevant tool from the toolkit. One striking aspect of growth experiences in LMIC is the adoption of policies during the two stages of shocks, that do not always account for the underlying differences in institutions, culture or environment. Even if economic principles are accepted as universal, their implementation is intermediated through local institutions.[175] These are a product of history and culture.

Governments in LMIC face tough choices when economic crises eventuate. This challenge is often worsened by political divisions, insecurity, and social unrest. In particularly acute and severe shocks, Governments face public pressure in rapidly responding, often with very limited resources. Limited resources confront policymakers with difficult trade-offs between policies that can have unintended, longer term, consequences in terms of taxation, debt, economic growth and social spending. Despite these challenges, case studies show that political regimes of all kinds survive most type of external shocks.[176]

5.2 Regulatory quality

Whether autocratic or democratic, the perception of the ability of Government to formulate and implement sound policies that permit and MSME development matters for building resilience.[177] Section 3.3 has investigated this in relation to case study countries. Only Malaysia shows gradual improvements in regulatory quality. Estimations for Brazil, Egypt and Ethiopia all worsened between the GFC and the onset of the COVID 19 pandemic. They then improved slightly during the COVID 19 pandemic.

Government must also be effective, agents must have confidence in the rule of law and corruption controlled, to effectively respond to stresses and direct support to businesses most at need. Among case study countries, Malaysia scores highest for government effectiveness and regulatory quality.[178] But even here, the novel nature of the COVID 19 pandemic required a degree of experimentation. Malaysia had implemented eight stimulus packages by April 2021. During severe shocks there is a need for institutions to be able to learn fast and adapt, while maintaining policy certainty.

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[174] World Bank, 2022, Poverty and shared prosperity in 2022: Correcting course, online, available at: www.worldbank.org/en/publication/poverty-and-shared-prosperity

[175] Mukand, S, The view from the developing world: Institutions, global shocks and economic adjustment, in Reversals of fortunes? A long term perspective on global economic prospects, online, available at: https://warwick.ac.uk/fac/soc/economics/research/centres/cage/publications/policyreports/policy-report-reversals-of-fortune/

[176] Shih, M et al, 2020, Economic shocks and authoritarian stability: Duration, financial control and institutions, University of Michigan, online, available at: https://press.umich.edu/Books/E/Economic-Shocks-and-Authoritarian-Stability#:~:text=Reviews,they%20change%20how%20they%20rule.

[177] World Bank, Regulatory quality, online, available at: https://www.worldbank.org/content/dam/sites/govindicators/doc/rq.pdf

5.3 Government business relations across segments of businesses

Larger and older firms were more likely to receive support from LMIC government. Where government performs well in protecting and promoting private sector development, there could be variations in the extent of promotion of protection across types of MSME. Across case study countries, larger and older firms, and those that had received support prior to the COVID 19 pandemic, were more likely to receive support during the COVID 19 pandemic. Smaller and younger firms have been less able to concentrate their influence both before and during the COVID 19 pandemic. This resulted in support packages not always recognising the unique needs of smaller and younger businesses. There is a need to support the concentration of influence among smaller businesses, to shift the system for state business relations towards a greater recognition of the specific needs and expectations of MSME. Private sector organisations and trade union organisations can lead this endeavour. This is especially pressing since MSME contribute to 70% of employment worldwide. The employment share of micro enterprises is much higher in low-income countries, than in middle- and high-income countries.[179]

The risks of unequal state business relations has been born out in past crises. Across East Asia, strong business government relations contributed to fast growth rates before the Asian Financial Crisis. But these relations, caused a moral hazard.[180] Greater institutional and political checks on business influence, could have increased resilience during the shock. This is particularly the case for concentrated commercial interests, of usually larger businesses, with close links to authorities. MSME were therefore less able to concentrate their interests and influence the response to the Asian Financial Crisis.

State owned, and strategic businesses, are more likely to receive support- to the detriment of MSMEs. Egypt's system for state business relations has created influential state-owned enterprises. The military also plays an important role in the economy. This is particularly important for finance, where there is a high prevalence of state-owned enterprises in the banking system. Meanwhile there are high levels of informality, and smaller businesses have not been able to concentrate their influence. Support received pre COVID 19 pandemic, was a key determinant of support provided during and after the COVID 19 pandemic. In Egypt, larger and older firms, were more likely to receive support. While, smaller and younger firms, were less likely to receive support.[181]

Smaller firms in Latin America have been challenged in concentrating their influence. Here, small firms (fewer than five employees) and informal firms were less aware of existing programs, less likely to apply for aid and less likely to receive aid. Meanwhile businesses that did receive aid (which were more likely to be formal and medium or large sized), reported better outcomes and expectations about the future.

In Ethiopia, government industry relations differ within industries.[182] These have influenced policy outcomes unevenly. Trust and collective learning has been established in floriculture, and logistical privileges have been established. However in leather, path dependency and internal fragmentation has undermined

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[179] ILO, 2019, Small Matters, online, available at: https://www.ilo.org/publications/small-matters-global-evidence-contribution-employment-self-employed-micro
[180] Wild, L, State capacity and response to external economic shocks, Overseas Development Institute, online, available at: https://assets.publishing.service.gov.uk/media/57a08a5fed915d3cfd000726/60895-Part2_Crisis_lit_review-state_capacity.pdf
[181] El Haddadd, A, 2023, The role of political connections in COVID policy response: Effectiveness of firm level government support in Egypt, The Journal of Development Studies, online, available at: https://www.tandfonline.com/doi/full/10.1080/00220388.2023.2204179
[182] Oqubay, A, 2018, Industrial policy and late industrialisation in Ethiopia, African Development Bank, Working Paper no. 303

collective learning. Overall, there is a system of mutual suspicion that has been exacerbated by a lack of dynamism in the associations and short termism in the private sector.

In Malaysia, despite a wide-ranging package of support relevant to MSME, smaller businesses were confounded by the large number of relief packages. A total of eight packages were introduced during the COVID 19 pandemic. This created uncertainty for entrepreneurs, and challenges with access and administration. More certainty could have been achieved, through maintaining consistency in support packages and enhancing effort to communication.

5.4 Coordination of the response to shocks

Governments face challenges in coordinating their actions. Enhanced coordination among agencies is instrumental to the provision of efficient and effective crisis support. However, case study countries used existing coordination mechanisms during the COVID 19 pandemic.[183]

In advanced economies and some LMIC, new structures were established. In Denmark a new Government and Business Corona Unit was established, to discuss temporary and targeted measures for businesses. While in France, regional task forces were established with public development banks to accelerate and refine support to businesses.[184] Given the role of state-owned development banks in LMIC, this could have relevance to future shocks in LMIC.

Coordination can be organised in different ways in different countries. New coordination structures can be deployed, or existing ones adapted. Whichever is determined, the i) role of each participating institution should be clear, ii) sufficient expertise should be available and iii) data should be employed. There are risks that key agencies and organisations are not included, and technical expertise is not available or acted upon. Data needs are discussed in Part 6. Importantly, coordination bodies should be inclusive of MSME, and their representative organisations. Experience from case study countries, suggests that greater emphasis should be given to communicating the support available to smaller businesses. Coordination mechanisms should also design mechanisms to ensure that support is accessible to MSME. Early evaluations from advanced economies, support this view. In advanced economies:

- Interagency cooperation requires commitment and fit for purpose governance arrangements; and
- More targeted and coherent communication is required to build trust.[185]

There would also be benefit for donors in LMIC to enhance the coordination of their efforts. In some case study countries, interviews suggested that major donors are inactive in donor coordination bodies and information is not shared between implementers and funding bodies. There is a need to improve coordination among agencies during normal times, and during shocks.

[183] ILO, 2023, A framework to support small firms in developing countries navigate crises and build resilience, online, available at: https://www.ilo.org/publications/framework-support-small-firms-developing-countries-navigate-crises-and#:~:text=Report-,A%20framework%20to%20support%20small%20firms%20in%20developing%20countries%20navigate,small%20firms%20during%20such%20conditions.
[184] OECD, 2020, Coronavirus: SME policy responses, online, available at: https://www.oecd.org/coronavirus/policy-responses/coronavirus-covid-19-sme-policy-responses-04440101/
[185] OECD, 2022, First lessons from government evaluations of COVI9 responses: A synthesis, online, available at: https://read.oecd-ilibrary.org/view/?ref=1125_1125436-7j5hea8nk4&title=First-lessons-from-government-evaluations-of-COVID-19-responses

Coordination in Malaysia

In Malaysia the SME Hub served as a one stop shop for small firms to access information on support programmes, including those of third-party organisations. This was housed within Malaysia's SME Corporation. This is a government body that "promotes the development of competitive, innovative and resilient SMEs, through effective coordination and provision of business support". The unit conducts research on SME performance, proposes policies to the national SME development council, and coordinates and monitors support programs across 17 ministries and more than 60 government agencies. This hub was particularly busy given the number of support packages announced in Malaysia.

Coordination in Brazil

During the pandemic, Brazil's Support Services for Micro and Small Firms focused on i) providing information and consulting services, ii) coordinating with financial partners on priority sector solutions, iii) coordinating the government to promote business environment measures, and iv) strengthening credit and access to financing actions through the agency responsible for credit guarantee funds. A crisis committee was created for projects in execution. Rapid research was also undertaken. This direct coordination with firms enabled a faster identification of critical issues and priorities. The linkages with different levels of Government, allowed for coordination of the response at local levels.

5.5 Public private and social dialogue

Public private and social dialogue can lift the profile of the needs of the specific needs of different segments of MSMEs. There is a need, across economies, for Government to involve civil society, the private sector and local actors to increase transparency in decision making, as well as the relevance, efficiency and effectiveness of support.[186] This is especially pressing when rapidly designing and deploying measures to support businesses during shocks. Under these conditions, data may not always be available to inform evidence-based decision making.

There are costs to relevance and efficiency, of frequently adapting support measures. This was experienced in Malaysia. One way this can be addressed, is to bolster public private dialogue and tripartite dialogue functions, and sustain these after crises. Alongside ensuring the inclusiveness and balance of tripartite dialogue, deploying new technologies can enable effective dialogue.[187]

Social dialogue can help governments source views from stakeholders with direct interest in the measures being considered. This could have avoided design failures that were apparent during the COVID 19 pandemic. While improved dialogue would generate benefits during normal times, during crises dialogue, alongside improved data, can support:

- Government officials in coordination, initiation, formulation, implementation and lesson learning;

[186] OECD, 2022, First lessons from government evaluations of COVI9 responses: A synthesis, online, available at: https://read.oecd-ilibrary.org/view/?ref=1125_1125436-7j5hea8nk4&title=First-lessons-from-government-evaluations-of-COVID-19-responses
[187] Nielsen, W, 2021, Public private dialogue with the use of new technologies: A focus on feedback tools and their integration with data driven policy reform, A research report, Donor Committee for Enterprise Development, Cambridge, UK

- Business associations in representing the needs and capabilities of their members, including particular segments of businesses; and,
- Trade unions can represent workers, to enable the maintenance of the employer employee relationship and the efficient reallocation of labour.[188]

Recommendations

- Authorities in LMIC, with donor support, should increase the capability of MSME, including informal ones, to organise and concentrate their interest in tripartite dialogue fora to enable a more effective response to future shocks
- In preparation for future shocks, authorities in LMIC, with donor support, should prepare to establish coordination platforms that focus on the specific needs of MSME
- Authorities in LMIC, with support from donors, should establish technology enabled public private dialogue mechanisms to manage future shocks

[188] ILO, 2023, A framework to support small firms in developing countries navigate crises and build resilience, online, available at: https://www.ilo.org/publications/framework-support-small-firms-developing-countries-navigate-crises-and#:~:text=Report-,A%20framework%20to%20support%20small%20firms%20in%20developing%20countries%20navigate,small%20firms%20during%20such%20conditions

6. What types of data indicating firm and economic performance may be used as evidence for resilience? What possible explanatory factors may account for the patterns detected?

Information asymmetries between policy makers and MSMEs exist, and this hampers resilience. Sections 3 and 4 have identified the need to improve the targeting of support to bolster resilience and improve the effectiveness of public expenditure in managing shocks. This is relevant to donor support and LMIC government across countries to build resilience. Improved targeting is also relevant within countries, to identify businesses most in need during shocks. This requires improving the availability and use of data. Caution is however required, since there is considerable heterogeneity among shocks, economies and businesses.

6.1 Economic performance

Despite the relevance of economic resilience, resilience remains inconsistently theorised. Achieving consistency in theory is confounded by the heterogeneity of shocks and contexts. Since the GFC concepts of fiscal and monetary policy space have risen in prominence.[189] Since then several indicators have been formulated, but because of theoretical and methodological controversies, and the availability of data across countries, a widely accepted indicator does not yet exist. Most indicators consider resilience to consist of both i) instantaneous resilience and ii) dynamic resilience.[190] This cover limiting immediate losses and the rapidity of reconstruction and recovery, respectively.

6.1.1 A simple economic resilience indicator

A simple economic resilience indicator has been introduced in Section 3 and applied to case study countries. This is one of several efforts to measure economic resilience. The concepts and indicators include:

- Capacity to withstand the immediate impact of an adverse economic exogenous shock:

[189] Strauss-Kahn, Dominique. 2008. "The Case for a Global Fiscal Boost." Financial Times, January 30

[190] Hallegate, S, 2014, economic resilience: definition and measurement, World Bank Policy Research Working Paper, online, available at: https://elibrary.worldbank.org/doi/abs/10.1596/1813-9450-6852

    - External financing needs: Current account deficit and short-term debt obligations as a percentage of international reserves;
    - External solvency: Present value of external debt as a percentage of GNI;
- Capacity to promptly respond to the effect of an adverse economic exogenous shock:
    - Fiscal balance: Fiscal balance as a % of GDP;
    - Government indebtedness: General government debt as a percentage of GDP;
    - Monetary policy space: Deviation of inflation from target; and,
    - Institutional and regulatory quality: regulatory quality.

Section 3 demonstrates that Ethiopia is the least resilient of case study countries using this indicator, and Malaysia the most resilient. Ethiopia, a low-income country, with entrenched domestic and external imbalances that reduce resilience. It deployed a narrow range of measures, and was not able to sufficiently fund the rapid expansion of social safety nets to support informal workers or entrepreneurs during the COVID 19 pandemic. Countries with these characteristics could make better use of the principles of Risk Informed Development. This is introduced in Section 3. Malaysia, a middle-income country, has followed a path of fiscal prudence, successful export orientation and credible monetary policy- building on the lessons from past crises. It was able to deploy a broad range of tools to cushion the economic impact of the COVID 19 pandemic on MSME.

6.1.2 More complex indicators

More complex indicators do exist, and these have evolved. During the GFC, a resilience indicator was formulated that aimed to measure the effect of shock absorption and shock counteraction policies.[191] This included measures of i) macroeconomic stability, ii) micro economic market efficiency, iii) good governance and iv) social development. This was updated in 2016 to account for the increasing relevance of environmental governance and increased exposure of the real sector to financial markets instability, among others. The following measures were included in the updated index.[192]

- Macroeconomic stability;
    - Government debt as a percentage of GDP;
    - Inflation, as measured by the GDP deflator;
    - Current account balance;
- Microeconomic market efficiency composed of;
    - Free markets and resilience (labour market regulation[193] and business regulations of the Freedom of the World Index);
    - Free markets and financial prudence (soundness of banks and regulation of securities exchanges from the Global Competitiveness Index)
- Good governance;
    - Political governance as measured by the World Governance Indicators;
    - Social governance (as measured by health and education outcomes of the Human Development Index); and,
    - Environmental governance (as measured by the Environmental Performance Index.

Small island states sometimes demonstrate high levels of resilience. These economies adopt policies that enable them to withstand the impact of exogenous shocks. Meanwhile, several countries, mostly large

[191] Briguglio, L, et al, 2009, Economic vulnerability and resilience: Concepts and measures, UNU WIDER, https://www.wider.unu.edu/publication/economic-vulnerability-and-resilience-0
[192] Briguglio, L, 2016, Exposure to external shocks and economic resilience of countries: Evidence from global indicators, Journal of Economic Studies, online, available at: https://www.emerald.com/insight/content/doi/10.1108/JES-12-2014-0203/full/pdf?title=exposure-to-external-shocks-and-economic-resilience-of-countries-evidence-from-global-indicators

and poor developing countries, that are not exposed to external shocks due to their limited dependence on external trade, emerged with low degrees of policy induced resilience.

The flexibility of labour regulations, under 2a, is a controversial issue. The COVID crisis has highlighted the importance of labour protection, and its inclusivity, to the resilience of workers and business sustainability. Workers with inadequate or no labour protection at all, especially those in informal employment, have fared much worse than workers enjoying better protection at work.[194] This highlighted the need to strengthening and extending existing forms of labour protection, while also exploring new forms of protection, and improving their application rather than the need for flexibility.

Another composite indicator attempts to capture vulnerability to disasters, and macro and micro economic resilience. The latter was captured at the household level, to account for welfare changes. Household level data could be replaced with data capturing the resilience of MSME. This indicator accounted for:

- The probability of occurrence of disasters (vulnerability);
- The exposure to possible disasters (vulnerability), represented by:
  - The total affected capital and the number of affected households;
- The vulnerability of exposed capital;
- Macro-economic resilience;
  - The interest rate and marginal capital productivity;
  - The reconstruction duration in years, which depends on the ability of the economy to mobilise financial and technical resources to rebuild;
  - The ripple effect that amplifies or diminish instantaneous production losses, which depend on the idle resources available in the economy;
- Micro economic resilience that depends on:
  - The level of income in the country;
  - The inequality level, with higher inequality countries being less resilient to disasters;
  - The poverty bias of disasters i.e. the exposure of the poor;
  - The heterogeneity in direct losses across households;
  - The ability of households to smooth income shocks due to insurance, savings or borrowing;
  - The maximum losses of welfare that a household can suffer, which is linked to basis serves for the poorest;
  - The amount of risk sharing in the economy, that depends on social protection systems and insurance. [195]

Innovations in the measurement of economic resilience continue. An innovation in upper income countries, reduces the emphasis on fiscal and monetary policy space and increases emphasis on investment in research and development, the contribution of services to GDP and social progress, among others. These have relevance to LMIC, alongside fiscal and monetary policy space and regulatory quality. The Zoe Institute for Future Fit Economies measures and compares the resilience of 25 European Union countries.[196] This indicator includes the following dimensions.

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[194] ILO, 2022, Towards More Effective Labour Protection for all Workers and Increased Resilience of the Economy, online, available at: https://www.ilo.org/media/373776/download
[195] Hallegate, S, 2014, Economic resilience: Definitions and measurement, online, available at: https://documents1.worldbank.org/curated/en/350411468149663792/pdf/WPS6852.pdf
[196] EC, 2023, Economic Resilience Indicator, online, available at: https://composite-indicators.jrc.ec.europa.eu/explorer/explorer/indices/eri/economic-resilience-index

- Economic independence (economic complexity index, energy import dependency, export partner concentration etc.);
- Governance (international cooperation in research, regulatory quality, trust in government and government spending on social services etc.);
- Education and skills (adult participation in education, brain retention, scientific publications etc.);
- Production capacity (information communication technology service sector in GDP, innovation enterprises, investment share of GDP);
- Financial resilience (financial constraints of firms, household savings rate, refinancing cost etc.); and,
- Social progress and cohesion (gender employment gap, employees in trade unions etc.).

6.2 Firm performance

Early consideration of business resilience focused on productivity. This included Schumpeter's creative destruction theory, and more recently work by Melitz and Ottaviano.[197] Less productive firms are expected to be culled during crises. The implication of this research is that firms should focus on having formal plans to respond to crises, while increasing productivity. However, this theory has not held up well in LMIC, due to credit constraints and high levels of informality.

The COVID 19 pandemic challenged the position of creative destruction theorists. Studies have shown that market imperfections can hurt even the most productive firms. During the COVID 19 pandemic, firms were projected to suffer from untimely deaths regardless of their age, size or productivity levels, and MSME were most in need of support.[198] The implication of this was to adopt a capability centric approach to adapt to adversity. The creative destruction theory also doesn't take into account the positive externalities that unproductive firms deliver, including their ability to absorb low qualified workers.

6.2.1 Composite indicators of business resilience

Efforts to establish a business resilience index continue. The International Labour Organisation has constructed a Business Resilience Indicator. This aims not to capture resilience as an outcome, but as a capability of businesses. This comprises of 44 indicators, divided into five dimensions.[199] These dimensions span:

- Institutions;
  - Political;
  - Regulatory;
  - Business;
- Human capital;
  - Knowledge and stock flows;
  - Knowledge creation and impact;
- Technology and innovation;
  - Research and development;
  - Infrastructure;
  - Innovation
- Financial status;

[197] Melitz, M and G, Ottaviano, 2008, Market size, trade and productivity, Review of Economic Studies, no. 75
[198] Bosio, E, et al, 2000, Survival of firms during economic crisis, World Bank Policy Research Working Paper 9239, online, available at: https://documents1.worldbank.org/curated/en/140091589221773664/pdf/Survival-of-Firms-during-Economic-Crisis.pdf
[199] ILO, 2023, A conceptual framework for measuring business resilience: online, available at: https://webapps.ilo.org/wcmsp5/groups/public/---ed_dialogue/---act_emp/documents/publication/wcms_888045.pdf

    - Liquidity;
    - Funding; and,
- Management practices.

The sources utilised consist of both hard and perception related data. Data was only available for 50 economies, however. No case study countries were included in the report. Annex 2 details the indicators used. Business specific information was utilised for training, collaboration in research and development, production process sophistication, cluster development, financial obstacles and overdraft facilities.

6.2.2 Measuring resilience during a shock

Information asymmetries between firms and policymakers, designing and deploying support during a shock, are extremely pervasive. Firms have private information on their productivity, business prospects and cost structure. These are typically unobserved by those formulating and implementing policy, especially in developing countries where capabilities are more limited.

To measure resilience as an outcome and target support, it would be necessary to track firms over time. This will allow for the identification of firms that were able to recover from disruptions. International organisations have not yet embarked on a global effort to build a resilience index for businesses in LMIC, although empirical work has begun. The International Labour Organisation has recently deployed principal component analysis and least absolute shrinkage and selection operator analyses. In the principal component equation, correlation was measured between the sales performance of firms and:

- A macro index,
- A meso index;
- A micro index;
- A firm index;
- Sector fixed effects;
- Date fixed effects; and,
- Country fixed effects. [200]

The analyses demonstrated that small firms were hit hardest by the COVID 19 pandemic. This negative effect continued through the three waves analysed. MSME were found to have fewer instruments with which to manage shocks. The changes to enterprise sales also differed by sector. Firms in tourism were affected most quickly and deeply, while construction sales continued to decline through the third wave.

Resilience indicators for global businesses do exist. Accenture analysed 1,615 global companies across three performance dimensions.[201] Less than a fifth of these were able to sustain profitable growth before, during and after disruptive growth. Those that did sustain profitable growth exhibited a balanced strength across i) financial health, ii) value chain strength and iii) technology maturity, as an enabler of agility, innovation and trust.

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[200] ILO, 2023, Determinants of productivity recovery and business resilience, online, available at: https://www.ilo.org/publications/determinants-productivity-recovery-and-business-resilience
[201] Accenture, 2023, Reinventing for resilience: A CEO's guide to achieving long term profitable growth, online, available at: https://www.accenture.com/content/dam/accenture/final/accenture-com/document/Accenture-Reinventing-for-Resilience-CEO-Guide.pdf#zoom=40

There remains a need to improve the surveillance of outcomes during shocks in LMIC. Disruptive situations mostly effect sales and then employment, liquidity and productivity. These variables are relevant to measuring the resilience of businesses as an outcome, to inform the targeting of support. Doing so, would enable regulations that enhance resilience.[202]

6.2.3 The challenge of considering future viability

The timeliness of data matters, as does the assessment of future viability. During a major shock, rapid changes occur, and support measures are designed and deployed rapidly. However, governments are constrained in being able to identify businesses most in need. For example, there are challenges in using tax data, which had to be available for two years during the COVID 19 pandemic. This was not available to deliver timely support to businesses most in need. Simplified quarterly accounts, could assist in identifying which firms should benefit from support. This could include projections of income, employment and liquidity, to improve targeting.

Despite the attraction of debt finance to policy makers, assessing solvency and viability is extremely challenging. One of the benefits of deploying debt finance, is the ability of firms and lenders to self-select the utilisation of this tool. Financial data can then be utilised to make lending decisions. In Argentina, novel approaches were deployed through the sharing of regulatory and financial information between approved lenders, businesses and regulators. Other countries could prepare to deploy this approach during future shocks. This data needs to be up to date, and where possible allow for assessment to be made of future viability. However, forecasting sales and liquidity in a shock, is challenging given uncertainty.

In a crisis, there is a need for measures of business performance to be forward looking. Identifying the future viability of businesses can improve the targeting of support. Viability can be determined by establishing if the discounted value exceeds the recovery value of assets through forced sale. This can be calculated through tax returns and calculations of future earnings before interest, taxes, depreciation and amortization. This data is often not available, especially for smaller businesses.

Different degrees of financial distress, determine the relevance of support and instruments. Levels of financial distress, and the support required and possible instruments, are displayed in Table 13. Ideally, measures of solvency and viability should be deployed to target measures to SME. Until this data is available, LMIC should segment firms and consider drivers of solvency and viability in SME.

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[202] Gola, S, et al, 2020, Trends and applications of resilience analytics in supply chain modelling: Systematic literature review in the context of the COVID 19 pandemic, Environment Systems and Decisions, no 40

Table 12: Targeting and required information according to different levels of financial distress[203]

Information needs	Support needed	Instruments
Evidence demonstrating viability and not facing financial distress	No targeted support required, firm development initiatives may still be relevant to achieve longer term objectives (exports, women's economic empowerment, circular economy etc.)	Instruments to enhance the business environment, access to finance support, facilitating access to markets, building firm capabilities. Possible relaxation of sector-specific regulatory restrictions. Pre-insolvency proceedings may also be used, where available, in anticipation of growing financial distress.
Evidence demonstrating viability and facing financial distress	Targeted support to solve liquidity problems	Support through grants and loans, pre solvency procedures may still be required
Evidence demonstrating viability and insolvency	Debt restructuring	Debt restructuring that benefits firms and lenders, this may include out of court and hybrid insolvency procedures
Evidence demonstrating unviability and being insolvent	Liquidation	Improved insolvency procedures

Recommendations

- To bolster surveillance, donors and multi-lateral organisations should direct increased effort to establish a composite indicator of business resilience, in partnership with LMIC authorities and business membership organisations, building on the International Labour Organisation's effort, across countries
- To bolster targeting during future shocks, donors and multi-lateral organisations should direct increased effort, in partnership with authorities in LMIC, to identifying robust and valid methods to assess viability and solvency among MSME during shocks
    - This may start by targeting segments of firms at risk during shocks, and which are particularly important for recovery

[203]Supporting firms in restructuring and recovery, online, available at: https://thedocs.worldbank.org/en/doc/109351615592343952-0130022021/original/FirmsNote2.0FINAL031221.pdf

7. Conclusion and overarching recommendations

LMIC face a broader range of acute exogenous shocks than advanced economies. The incidence of these shocks is expected to increase. This will impact on the volatility of growth in LMIC, and the achievement of the Sustainable Development Goals, should an increase in effort not be directed to improving the resilience of LMIC.

The overarching lessons and recommendations for LMIC resonate with those from advanced economies. While each shock and country is different, all countries are learning how to manage shocks. The early lessons from evaluations of COVID 19 responses in advanced economies suggests that:

- Investment in risk anticipation capacities and critical sectors was insufficient;
- Interagency cooperation requires commitment and fit for purpose governance arrangements;
- More targeted and coherent communication is required to build trust;
- Government could involve social partners, civil society, the private sector and local actors more to increase transparency in decision making, and the effectiveness of regulations designed to support business;
- Tax measures helped to support liquidity but didn't always target right type of beneficiaries;
- Balance sheet measures kept businesses afloat, but came with risks to long term budgetary costs; and,
- Countries rapidly deployed measures at supporting businesses but had to adapt them regularly, impacting relevance and effectiveness.[204]

LMIC have been buffeted by a series of severe economic shocks, and resilience has been hampered. These have left many economies, particularly low-income economies, in a perilous position. There is now a need to restore policy space and improve preparedness and responses to future shocks for MSMEs through business environment reforms. This can be achieved through authorities in LMIC, with donor support:

- Adopting the principles of Risk Informed Development in future development decisions;
- Urgently addressing external and internal imbalances, while progressing structural change;
- Adapting and supporting approaches in debt finance, employment support, tax measures, business cost measures and business environment reforms, among others, to be more suited to the shock, the capability of Government and the expectations of MSMEs;
- Strengthening the complementarity of support to MSMEs with efforts to prepare to implement, and implement, horizontally and vertically expanded social safety nets, to provide support to workers, the self-employed and entrepreneurs of micro enterprises;
- Improving the availability of data on economy wide and MSME specific resilience; and,
- Improving the institutional context, especially inclusive social dialogue that includes MSMEs, to enable effective preparation and response.

The recommendations from each chapter of this report are collated below.

[204] OECD, 2022, First lessons from Government evaluations of COVID 19 responses: A synthesis, online, available at: www.oecd.org/coronavirus/policy-responses/first-lessons-from-government-evaluations-of-covid-19-responses-a-synthesis-483507d6

Topic	Subtopic	Recommendation
Building resilience	External financing needs	• Governments in LMIC should manage short term external debt, foreign exchange accumulations and current account deficits to allow for flexibility in managing the immediate stresses of exogenous economic shocks • Development partners should continue to support LMIC in accessing resources to full fill their payments, conditionality should allow for addressing internal and external imbalances
	External solvency	• Governments of LMIC should manage the present value of external debt, as a percentage of GNI, within bounds of sustainability • Governments of LMIC should actively rebuild external solvency during normal business cycles
	Fiscal balances	• Governments of LMIC should achieve sustainable fiscal balances as a percentage of GDP • Governments of LMIC should actively seek to rebuild fiscal buffers during business cycles
	Government indebtedness	• Governments of LMIC should manage general government debt, as a percentage of GDP, to allow for space to respond to respond to crises
	Regulatory quality	• Governments of LMIC should increase emphasis on improving institutional and regulatory quality for MSME, especially during normal business cycles so that this does not recede, to enable effective responses to shocks • Development partners should consider establishing indices to capture the ability of LMIC governments to formulate and implement policies relevant to MSMEs and should maintain support to regulatory improvement to MSMEs during normal cycles
	General	• Macro economic managers in LMIC should balance a dual mandate of i) guardians of macro economic stability and ii) inclusive development • LMIC countries should take concerted action to adopt the principles of Risk Informed Development- to encompass multi hazards and the coping capacities of economies and businesses, while acknowledging the role of development decisions in creating known and unknown risks • Donors should channel support towards the effective adoption of Risk Informed Development practices in LMIC, and in their programmes
Business climate reforms	Debt finance	LMIC governments, with partner support, should: • Consider utilising debt finance measures during short term demand shocks, supply shocks and natural disasters • In preparing for shocks, address information asymmetries- through establishing processes to share information between registered regulators, SME and financiers

		• During emergency phase, allow for concessional long-term interest rates • Consider the future impact of guarantee schemes on public budgets • Consider establishing mechanisms to assess future solvency and current viability, in loan approval considerations • Consider targeting concessional finance to stimulate investment and innovation during the recovery phase • Consider complementing debt finance interventions, with the expansion of social safety nets to support entrepreneurs of smaller informal businesses and the self employed
	Employment support	LMIC governments, with partner support, should: • Consider utilising wage subsidies during short demand shocks and natural disasters, where fiscal policy space allows • Consider utilising wage subsidies during emergency phases, and then transition to retraining and hiring incentives during the recovery phases to efficiently reallocate labour • Prepare to complement wage subsidies with differing vertical and horizontal expansions of social safety nets, to support entrepreneurs and workers of informal businesses and the self employed during different types of stresses.
	Tax measures	LMIC governments, with donor support, should: • Consider utilising tax measures during short term demand shocks and natural disasters • Prepare to expand the use of tax measures, in low-income countries where access to finance in constrained • During short term demand shocks and natural disasters, prepare to allow MSME to defer tax payments • Prepare to implement simplified quarterly accounting practices, to enable the targeting of tax measures to those most in need • Avoid deploying measures that only benefit those that are in arrears in their tax payments • Prepare to deploy accelerated depreciation, research and development incentives and investment credits during the recovery phases
	Energy subsidies	LMIC governments, with donor support, should: • Consider utilising energy subsidies sparingly • When used during shocks, target energy support to the most vulnerable MSMEs • To further a green recovery, LMIC could consider incentivising: • Clean physical infrastructure investment; • Building efficiency retrofits; • Investment in educating and training a green workforce • Natural capital investment for ecosystem resilience; and, • Enhanced rural spending.

	Regulatory flexibility	LMIC governments, with donor support, should: • Consider preparing to adopt business closure reforms during shocks, and risk-based approaches to business opening during the recovery phase- this should occur alongside ongoing effort to lower the burden of regulatory compliance while protecting public policy outcomes • Authorities should establish regulatory frameworks to enable SME to enter into hibernation during short term shocks • Prepare to implement measures to allow for broader regulatory flexibility that protects public policy outcomes, particularly in trade regulations, during shocks
Institutional context	General	LMIC governments, with donor support, should: • Increase the capability of MSME, including informal MSMEs, to organise and concentrate their interest to enable a more effective response to future shocks • Establish coordination platforms that focus on the specific needs of MSME • Establish technology enabled tripartite dialogue mechanisms to enable effective management of future shocks
Data	General	• To bolster surveillance, donors and multi-lateral organisations should direct increased effort to establish a composite indicator of business resilience, in partnership with LMIC authorities and business membership organisations, building on the International Labour Organisation's effort, across countries • To bolster targeting during future shocks, donors and multi-lateral organisations should direct increased effort, in partnership with authorities in LMIC, to identifying robust and valid methods to assess viability and solvency among SME during shocks

Annex 1: Country classifications[205]

High vulnerability scores, low resilience scores

Algeria	Haiti
Angola	Iraq
Belarus	Libya
Bhutan	Mauritania
Bolivia	Micronesia
Central African Rep.	Mongolia
Chad	Nicaragua
Comoros	Nigeria
Congo, Democratic Republic	São Tomé/ Príncipe
Congo, Republic	Sierra Leone
Côte d'Ivoire	Solomon I.
	Tajikistan
Djibouti	Turkmenistan
Ecuador	Ukraine
Equatorial Guinea	Yemen
Guinea	Zimbabwe
Guinea-Bissau	

Borderline case high vulnerability scores

Azerbaijan	Marshall Islands
Cape Verde	Montenegro
Grenada	Papua New Guinea
Guyana	St Kitts and Nevis
Jamaica	St Vincent/ Grenadines
Jordan	Seychelles
Kiribati	Swaziland
Maldives	

High vulnerability scores, high resilience scores

Antigua/ Barbuda	Kuwait
Bahamas	Lithuania
Barbados	Luxembourg
Belgium	Malaysia
Belize	Malta
Botswana	Mauritius
Brunei	The Netherlands
Darussalam	Oman
Chile	Saint Lucia
Czech Republic	Samoa
Dominica	Saudi Arabia
Estonia	Singapore
Fiji	Slovak Rep.
Gabon	Taiwan
Hong Kong	Tonga
Hungary	Trinidad/ Tobago
Iceland	UAR
Ireland	Vanuatu
Korea	

Low vulnerability scores, low resilience scores

Afghanistan	Liberia
Argentina	Moldova
Brazil	Mozambique
Burundi	Myanmar
Egypt	Nepal
Eritrea	Niger
Ethiopia	Pakistan
Gambia	Russia
Iran	Senegal
Kyrgyz Republic	Sudan
Lao P.D.R.	Syria
Lebanon	Tanzania
Liberia	Togo
Madagascar	Uzbekistan
Malawi	Venezuela
Mali	Vietnam

Borderline case high vulnerability scores

Albania	Kazakhstan
Armenia	Kenya
Bangladesh	Latvia
Benin	Lesotho
Bosnia/ Herzegovina	Macedonia, FYR
Bulgaria	Mexico
Burkina Faso	Morocco
Cambodia	Namibia
Cameroon	Panama
China	Paraguay
Colombia	Peru
Costa Rica	Philippines
Croatia	Portugal
Cyprus	Romania
Dominican Republic	Rwanda
El Salvador	Serbia
Georgia	South Africa
Ghana	Spain
Greece	Sri Lanka
Guatemala	Suriname
Honduras	Thailand
India	Tunisia
Indonesia	Turkey
Israel	Uganda
Italy	Uruguay
	Zambia

Low vulnerability scores, high resilience scores

Australia	New Zealand
Austria	Norway
Bahrain	Poland
Canada	Qatar
Denmark	Slovenia
Finland	Sweden
France	Switzerland
Germany	UK
Japan	USA

[205] Briguglio, L, 2016, Exposure to external shocks and economic resilience of countries: Evidence from global indicators, Journal of Economic Studies, online, available at: https://www.emerald.com/insight/content/doi/10.1108/JES-12-2014-0203/full/pdf?title=exposure-to-external-shocks-and-economic-resilience-of-countries-evidence-from-global-indicators

Annex 2: Business Resilience Indicators[206]

Dimensions	Sub dimension	Indicator
Institutions	Political	The political, legal, operational or security risk index
		Government effectiveness index
	Regulatory	Regulatory quality index from the Worldwide Governance Indicators
		Rule of Law Index
		Cost of redundancy dismissal
	Business	Ease of starting business
		Ease of resolving insolvency
Human capital	Knowledge stock and flows	Tertiary enrolment, gross
		Extent of staff training
		On the job training
		Charges for use of intellectual property
		Telecommunications imports (% of total trade)
	Knowledge creation and impact	Number of resident patent applications filed at a given national or regional patent office
		Number of scientific and technical journal articles (per billion Purchasing Power Parity % GDP)
Technology capability	Research and development	Gross expenditure on research and development (% GDP)
		Average score of top three universities, according to QS world university ranking
		The extent to which businesses and universities collaborate on research and development
	Infrastructure	ICT access indicator from GII calculations
		ICT Use Index
		Quality of port infrastructure
		Quality of airport infrastructure
		Logistics Performance Indicator

[206] ILO, 2023, A conceptual framework for measuring business resilience: online, available at: https://webapps.ilo.org/wcmsp5/groups/public/---ed_dialogue/---act_emp/documents/publication/wcms_888045.pdf

	Innovation	Production process sophistication
		State of cluster development and depth
		Number of patent families filed in at least two offices
		Capacity for innovation
Financial	Liquidity	Financial obstacles
		Overdraft facility
	Funding	Ease of getting credit index
		Trustworthiness and confidence
		Financing equity market
		Domestic credit to the private sector (% of GDP)
Management		Management index
		Efficient use of talent
		Extent to which ICTs enable new organisational model

DCED

The Donor Committee for Enterprise Development