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The importance of protecting export-oriented firms

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Key Insights

1. Low-income and lower-middle-income countries in sub-Saharan Africa and South Asia need an estimated \$1.1 bn per day in income support. Many will be unable to fund this through taxation, aid or international financial markets and will have to look to other sources.
2. Export supply chains provide an opportunity to facilitate income support. Workers in this sector are often formally employed and can be more easily reached through policy. Further, exporting firms are more connected to financial institutions that can provide additional liquidity.
3. Exporting firms are a crucial source of foreign exchange earnings that are needed for the import of staple foods. A reduction in exports could lead to a reduction in food available for the population generating a new crisis. While governments can do little about international demand for their countries' exports, they should prioritise minimising internal disruption to export supply chains.

The COVID-19 crisis has hit everywhere at once. Lower-income countries should not expect large inflows of aid; they will be left largely to their own resources. Those resources are limited, so lower-income countries need to find leverage wherever they can. Export-oriented firms are one important source of leverage. The large, formal firms typically have relationships with banks and a solvency buffer. They also provide a conduit for reaching a part of the labour force. Using an example from the garment sector in Bangladesh, this Policy Insight shows how concessionary loans have been used to leverage limited government resources. The export sector also provides foreign currency earnings particularly important for countries that import a significant part of their basic food budget. The viability of exports will depend on international demand, but also on keeping the domestic part of the supply chain open.

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Private Enterprise Development
in Low-Income Countries

I. Introduction

The 2004 Boxing Day tsunami devastated Ache province in Indonesia and large sections of coastal Thailand, Sri Lanka and India. The international response was immediate, with huge inflows of aid from both governmental and nongovernmental sources. The aid inflows often exceeded the estimated damage. The process was long and the disaster devastating, but the donations allowed countries to rebuild in ways that in many places resulted in improved infras-

tructure. A similar story plays out in most large-scale disasters affecting lower-income countries.¹

The COVID-19 crisis is unlike any other in this regard. Because the crisis has hit all countries essentially at the same time, and has hit the high-income donor countries as well, substantial aid flows will not be forthcoming. The lower-income countries will be left largely to their own resources to deal with the health effects and economic fallout from COVID-19.

II. The Scale of the Problem

Estimates based on very credible post-COVID survey data from Bangladesh illustrate the sobering scale of the need. Using a nearly representative sample of urban and rural poor during the second week of April 2020, Rahman et al. (2020) find income losses of around 75% in urban slums and 67% in rural Bangladesh. Based on these data, the researchers estimate that roughly half the Bangladeshi population will be needing support of around \$0.70 per day to maintain nutritional health. A universal basic income pilot in Kenya fixes the transfer rate at \$0.75 per adult per day. These amounts imply expenditures of roughly \$1.3 billion per month in Bangladesh.

Scaling these estimates up to the low-income and lower-middle-income countries in South Asia (SA) and sub-Saharan Africa (SSA), the need is \$1.1 billion per day, around \$0.5 billion of which is for India - levels that will represent half or more of the tax collection in most lower-income countries. Gentilini et al. (2020) report that, as of late May 2020, social assistance cash transfer programmes are operating in 124 countries, with an impressive total of \$0.5 trillion committed globally. However, while the per capita commitment is \$99 in high-income countries, it

is \$1 in low-income countries - an order of magnitude smaller than the Bangladesh data indicate would be required during each month of the crisis.

The lack of commitment to cash transfer programmes in lower-income countries is not surprising when we consider the resources available in those countries. Bangladesh collected taxes equivalent to 8.8% of GDP in 2018 (World Bank data), implying that the required transfer alone would account for over half of government tax collections. Table 1 shows tax revenue data for lower-income countries in SSA and SA. Population-weighted, the lower-income countries in these regions collect 11% of GDP in taxes on average, and tax collections are lower than 10% of GDP in many of them. This compares with 30% or more in higher-income countries. These data ignore the fact that tax collection itself is falling dramatically.² Although external debt levels vary from quite low (e.g. 14% of GDP in the DRC and 29% in Nigeria) to quite substantial (e.g. 86% of GDP in Zambia and 109% in Mozambique). However, aside from funding from the IMF and World Bank, most of the lower-income countries have little access to international financial markets, even in this period of excess savings.

¹See Strömberg (2007) for an analysis of disaster aid flows and Eisensee and Strömberg (2007) for an interesting analysis of how high-income country news cycles affect aid flows following disasters.

²The Daily Star (22 May 2020) reports that tax collection fell by 57% in April 2020.

Table 1: GNI/capita, tax revenue and government debt for select low- and lower-middle-income countries

Country	GNI per capita (current US\$) ¹	Tax revenue (% of GDP) ²	Government Debt (% of GDP) ³
Central Africa			
Angola	3,370	9.2	109.8
Cameroon	1,440	12.2	40.9
Central African Republic	490	7.1	47.8
Chad	670	-	44.2
Congo, Dem. Rep.	490	-	14.7
Congo, Rep.	1,640	14.3	95.3
São Tomé and Príncipe	1,890	-	73.1
East Africa			
Burundi	280	13.6	59.4
Djibouti	3,190	-	-
Eritrea	720	-	189.2
Ethiopia	790	7.6	57.6
Kenya	1,620	15.7	60.8
Madagascar	510	10.0	38.4
Malawi	360	17.3	63.4
Mozambique	460	22.2	109.0
Rwanda	780	13.6	38.6
Somalia	130	0.0	-
South Sudan	1,130	-	41.8
Tanzania	1,020	11.8	38.1
Uganda	620	13.7	40.0
Zambia	1,430	15.2	85.7
Zimbabwe	1,790	15.3	11.0
North Africa			
Sudan	1,560	8.0	-
Southern Africa			
Lesotho	1,390	29.5	48.5
West Africa			
Benin	1,200	-	39.4
Burkina Faso	670	17.4	40.0
Côte d'Ivoire	1,600	16.2	37.8
Gambia, The	710	9.4	82.5
Ghana	2,130	11.9	63.2
Guinea	850	10.8	34.5
Guinea-Bissau	750	10.3	69.8
Liberia	610	12.9	55.4
Mali	840	15.9	40.5
Mauritania	1,160	-	-
Niger	390	-	42.0
Nigeria	1,960	-	29.4
Senegal	1,410	15.8	64.2
Sierra Leone	490	-	67.2
Togo	660	17.3	70.9
South Asia			
Afghanistan	550	9.3	-
Bangladesh	1,750	8.8	35.7
India	2,020	11.2	71.9
Nepal	970	20.7	30.1
Pakistan	1,590	-	83.5
South-East Asia & the Pacific			
Cambodia	1,390	15.8	28.5
Lao PDR	2,450	-	60.6
Myanmar	1,310	6.0	38.2
Papua New Guinea	2,570	12.6	38.4

¹ GNI per capita data (2018 except Eritrea, 2011 - constructed by Atlas method) extracted from the World Bank Open Data.

² Tax revenue data (multiple years) extracted from the World Bank Open Data.

³ Government debt data extracted primarily from the Fiscal Monitor, IMF (2020) and complemented by the Regional Economic Outlook: Sub-Saharan Africa, IMF (2020).

III. Leverage

The scale of the need is sobering. With limited indigenous resources, governments and aid agencies will need to look for leverage where they can find it. One important source of leverage is export supply chains. I illustrate both the promise and the challenge of this with another example from Bangladesh, this time from a government programme supporting wage payments to workers in the ready-made garment sector. In addition to their being a source of leverage for income support, a focus on export supply chains is also important for addressing a second concern: foreign currency earnings. Export earnings have fallen sharply in many countries as tourism has dried up and remittances have fallen. Yet, many lower-income countries import a substantial share of the food included in basic diets, including grains, which require access to foreign currency.

On 25 March, the Bangladeshi government announced a programme of support for export industries, which in Bangladesh means primarily the ready-made garment sector. The programme supports wage payments to workers, and nicely illustrates the use of leverage. It was announced as a 60 billion Bangladesh taka (roughly \$600 million) support programme for workers who make up around 6% of the labour force (Bangladesh LFS, Bangladesh Bureau of Statistics (2017)). It was designed so that there was no immediate budgetary impact to the government. Under the programme, banks make direct wage payments through electronic transfers to garment sector workers employed by participating factories. The payments are grounded in salary data from the pre-COVID period, provided by the (large and formal) factories. Payments to workers accrue as loans to the factories, with liquidity provided to the banking system by the central bank.

The loans-for-wages scheme provided liquidity to solvent factories, who take on additional debt in exchange. Factories needed the liquidity in large part because foreign buyers cancelled existing orders. Some buyers agreed to pay for production in process, others agreed to accept production in process while

demanding substantial discounts, and still other buyers refused to accept or pay anything even for work in progress.³ Because factories pay for fabric in advance, and fabric accounts for around three-quarters of the cost of production, the cancellation of orders left many factories in a precarious position.

With these liquidity issues in mind, the programme gave factories a six-month grace period, with full repayment over the 18 months thereafter. The hope is that both the ability to operate factories and the demand for goods will have returned to normal by late 2020 though, of course, that is uncertain. Thus, the cost of the programme to the government is unclear in the long run, as that depends on how widespread defaults on the loans are.

Even as the retail sectors in Europe and the US begin to re-open, it is unclear what the new normal will be. Aside from short-term issues of excess inventories, several large buyers - Debenhams in the UK; JCrew, Neiman Marcus and JC Penny in the US, for example - have declared bankruptcy, and will close at least some of their outlets. For Bangladeshi manufacturers, payments of existing orders and flow of future orders are both in doubt. Meanwhile, other brands look even more enviously at the Zara model of producing nearer to market and maintaining lower levels of inventories. COVID-19 is likely to accelerate the movement to all-Zara, but that transition is likely to be slow in any case. Moreover, even with its focus on local production, Zara parent Inditex is among the ten largest buyers in Bangladesh. So, a movement in the Zara direction does not imply an end to production of less rapidly changing styles in locations further from market.

The manufacturers' view of the future is important because an alternative to paying wages during the production hiatus is laying off workers. Bangladeshi labour law requires employers to pay around half of wages for a period of 45 days after laying off a worker. Factories with buying partners who have proven less reliable are likely to rely more heavily on layoffs.

³Workers Rights Consortium (2020) provides information on buyers who agreed to pay for work in progress and those that did not.

IV. The Importance of Export Supply Chains

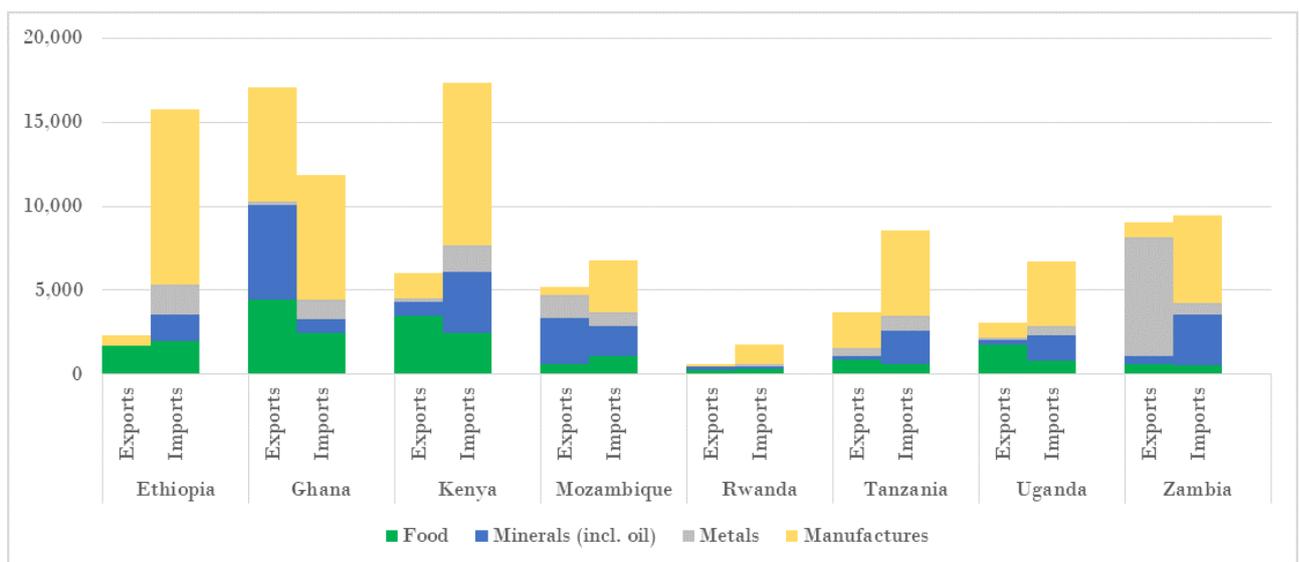
Bangladesh's case is extreme amongst the lower-income countries. More than 80% of the country's exports are garments, and garment demand has plummeted. But the leverage that exports provide in addressing the economic crisis is common across lower-income countries. Export industries are a natural lever for several reasons. First, there is evidence that firms that export are more skill- and capital-intensive, and pay higher wages, even conditioning on skills (Bernard et al., 2007). Thus, in terms of income flowing into communities, each job is more valuable. Second, exports are a source of foreign currency that will be particularly important for countries that import food that is part of the basic diet.

Figure 1 shows the distribution of exports and imports in selected countries in SA and SSA. In Africa the majority of exports are in minerals (including oil) and food, with manufactured goods accounting for a modest share of exports. In Asia, a larger share of exports come from manufacturing goods. In all of the countries - except Bangladesh, which imports fabric to export garments - food and oil make up the largest share of imports. Most of the countries shown in Fig-

ure 1 are net exporters of food. However, exports and imports do not substitute for one another. Exports are concentrated in a few products that are not part of the basic diet - coffee and cacao, for example - while imports are concentrated in grains and other basic staples. The countries and the international community must make sure that this adherence to comparative advantage does not become a disadvantage during the crisis.

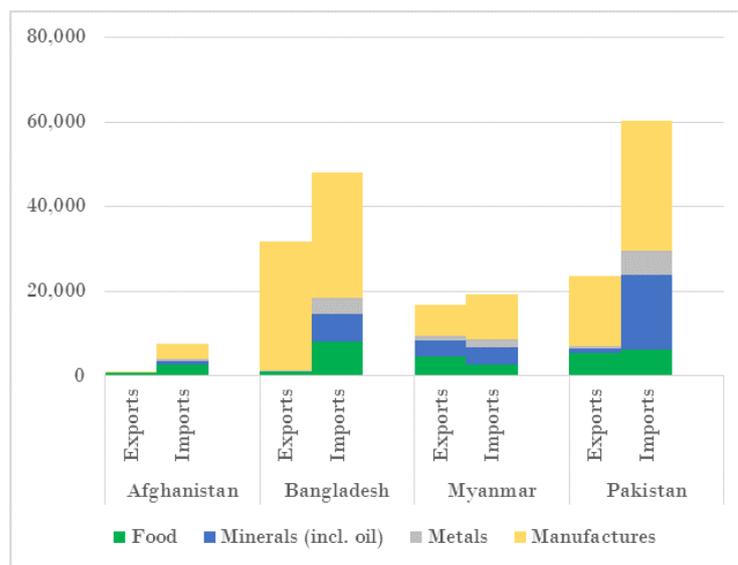
Commodity prices have softened but have not collapsed, and demand for food remains robust. So international markets should not have a large effect on the ability of countries to export. However, there are several other potential sources of disruption to exports that warrant some diligence. First is the logistics of ports and international transport. Of more direct control by governments is disruptions in the domestic part of supply chains. Restrictions on internal migration may be important for health reasons, but may also disrupt mobility of workers required for seasonal agricultural work. Restrictions on travel may disrupt local transport.

Figure 1a: Exports and imports by category for select sub-Saharan African countries (millions USD)¹



¹ Export and import data extracted from UN Comtrade (2020), calculations by author

Figure 1b: Exports and imports by category for select South Asian countries (millions USD)



V. Conclusions

Export industries are crucial in the crisis because workers in the sector are often formally employed and hence reachable through policy. The firms also typically have formal employment records, relationships with banks and other financial institutions, and a solvency buffer. Moreover, the large export-oriented firms are likely valuable to save. They often embody substantial relationship capital, embedded in relationships with customers, relationships with suppliers, or relationships among employees.

In contrast, a large majority of the urban labour force in the lower-income countries is either self-employed or employed as an informal wage worker. Direct replacement of the wages and earnings of these work-

ers is not feasible, because enterprises have no verifiable records of wages or profits. There is little reason to invest scarce resources in saving the vast majority of these small-scale enterprises, as little relationship capital would be lost if the enterprises were dissolved and re-formed after the crisis.⁴

Keeping exports moving and leveraging solvency in large formal firms is not enough to meet the needs of the new poor generated by the COVID-19 lockdowns. That may imply the need to allocate PPE and testing capacity at important points on the chain where social distancing is impractical. However, given limited fiscal resources, export-oriented firms represent a crucial lever that governments will need in the crisis.

⁴An exception may be enterprises that operate in the domestic food supply chain, which also needs to be kept robust during the crisis.

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