DEBrief

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The Effect of COVID-19 on Firms and Employment in Central America

- Since the COVID-19 outbreak, 1 in 4 formal businesses in El Salvador, Guatemala, Honduras, and Nicaragua have closed.
- Small firms exhibited the largest declines in sales and employment and faced greater liquidity constraints.
- To counter the impact of the crisis, firms opted to decrease total hours worked, reduce wages or furlough workers.
- Firms' response in terms of employment was highly correlated to the change in sales and affected by labor regulations.
- The ability of formal firms to start or increase remote work helped cushion the impact on employment.
- Despite increases in public spending and policies to mitigate the impacts of the pandemic, few formal firms received government assistance.

8 DECENT WORK AND ECONOMIC GROWTH

CENTRAL AMERICAN CONTEXT

The Central American region, including Panama and the Dominican Republic, contracted 6.7% in 2020, slightly lower than the downturn in Latin America but with big differences across countries. This contraction caused a 13.8% decline in working hours, equivalent to 10 million full-time jobs lost.[1] With already high levels of informal employment pre-pandemic—up to 80% of workers are informal in Honduras and Guatemala—the steep economic recession has led to about 2.8 million people falling into poverty across the Central American region.[2]

Given the importance for employment and wellbeing, the effects of the crisis on firms are being widely studied across the world. A joint IDB-IDB Invest study provides a comprehensive analysis of the short-term impact of the pandemic on businesses and formal employment in El Salvador, Guatemala, Honduras, and Nicaragua using the most recent World Bank COVID-19 Business Pulse Surveys[3] and other complementary sources.

MAIN FINDINGS

Business closures

Since the COVID-19 outbreak, nearly 70% of firms across Central America have temporarily closed at least once, with the highest rate in Honduras (86%) and lowest in Nicaragua (34%).

As of January 2021, 1 in 4 businesses were closed or were assumed to have permanently closed. Honduras also has the highest firm exit rate at 26%, compared to 18% in El Salvador and Guatemala. Although firms in Nicaragua have the lowest share of temporary closures, they have the second highest share of permanent closures. This finding shows that the effect of the pandemic was high, even without strict lockdown measures. Large firms had a lower probability of be-

ing closed in all countries analyzed (14%) relative to medium (24%) and small firms (25%). Similarly, manufacturing firms were more likely to be closed relative to firms in retail and other services.

Sales

Firms in all four countries experienced drops in sales during the crisis, either due to strict lockdown measures or because of reduced demand (local or external). Between January 2020 and January 2021, monthly sales dropped by a third on average in all countries. Small businesses, particularly in the services and manufacturing sectors saw the largest decrease in monthly sales.

Liquidity

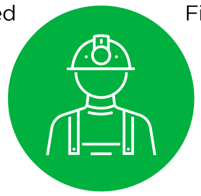
Over 80% of firms report a decrease in liquidity or cash flow availability since the pandemic began. While less pronounced than their smaller counterparts, seven out of ten larger firms experienced decreased cash flows in all four countries. This has led many businesses to struggle to cover their fixed operating costs and to fall behind on debt obligations to financial institutions. Smaller firms were also more likely to de-

1. ILO (2020). ILO SCORE Global COVID-19 Enterprise Survey. How Are Enterprises Affected and How Can We Support Them?
2. IDB (2021). Inequality and Social Discontent: How to Address Them through Public Policy: Economic Report on Central America, the Dominican Republic, Haiti, Mexico, and Panama.
3. First round of data collection June-August 2020; second round November 2020-January 2021. Small businesses with fewer than 20 employees account for nearly 40% of observations in all countries; most businesses are in the manufacturing or services sector.

lay payments to suppliers, highlighting the higher effect of the pandemic on such firms.

Employment

The employment response to the COVID-19 shock among firms has mainly been to reduce total hours worked, decrease wages or furlough workers. Furthermore, the higher the reduction in sales suffered by firms, the higher the probability of reducing hours worked, decreasing wages, or furloughing employees, and to a lesser extent, laying off workers. At the peak of lockdown (August 2020), approximately nine out of ten firms across Northern Triangle countries and over two-thirds in Nicaragua resorted to worker layoffs or reducing hours worked (Figure 1). By January 2021 as mobility restrictions were eased and economies showed signs of recovery, this figure dropped between 10 to 20 percentage points, particularly in terms of hours worked.



Firm employment responses also reflected government policies. For example, in Honduras, the government implemented a policy allowing companies to furlough workers without pay for up to three months. Consequently, in August 2020, the share of firms furloughing workers was higher in Honduras at 43%, versus 36% in Guatemala and 19% in Nicaragua.

Finally, similar to other regions of the world, women were disproportionately affected by the crisis. At the peak of the pandemic, over a third of female workers were laid off in all four countries. However by January 2021, in all countries but El Salvador, the proportion of women laid off decreased, potentially a sign of economic recovery. The proportion of women among furloughed workers increased between August 2020 and January 2021 in all countries expect Guatemala.

Online business activity and telework

Expanding teleworking and the use of digital platforms helped mitigate the impact on employment. Even though the possibility of remote work is limited across Central America (a mere 11% of the workforce is employed by teleworking firms), over half of firms among Northern Triangle countries and a quarter in Nicaragua started or increased remote work. Likewise, the majority of Central American firms started or increased online business activity.

Firm-level public policy support

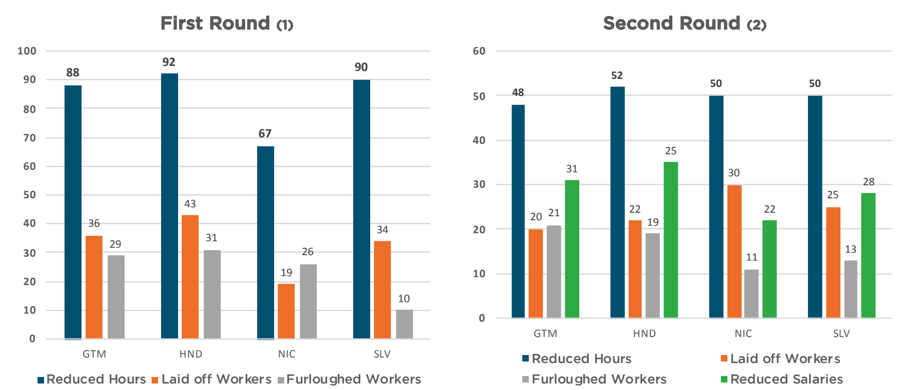
Despite increases in public spending and several policies to mitigate the economic and social impacts of the pandemic, few formal firms received government assistance. Approximately only one in ten firms in Guatemala and Honduras were likely to receive or expected to receive government assistance as of January 2021, followed by only 3% in Nicaragua. Deferral of payments and wage subsidies were the most common type of government assistance. As of January 2021, the majority of firms in all four countries identified fiscal relief as their most pressing need.

CONCLUSION

In the short-term, the path to recovery in Central America largely depends on the duration of the pandemic. In the long-run, it is still unclear if COVID-19 will have a permanent effect on employment.

In this context, development finance institutions such as the IDB and IDB Invest play a key role in economic recovery by facilitating access to short- and long-term financing for firms, particularly for smaller firms in the most affected sectors and segments, as well as deploying technical assistance to help firms reignite their operations. ■

Figure 1: Firms' Employment Response, By Country and Survey Round



Source: World Bank COVID-19 Business Pulse Survey. Notes: (1) June-August 2020. In the first round there was no information about reduced wages. (2) November 2020-January 2021.

Additional Information

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This DEBrief summarizes the findings of the study by Reyes Aterido, Giselle Del Carmen Hasbun, Marta Ruiz-Arranz, and Rodolfo Stucchi, (2021), The Effect of COVID-19 on Firms and Employment in Central America, which is part of IDB Invest's Development through the Private Sector Series.

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