WORLD BANK GROUP

Schweizerische Eidgenossenschaft
Confédération suisse
Confederazione Svizzera
Confederaziun svizra

Swiss Confederation

Federal Department of Economic Affairs,
Education and Research EAER
State Secretariat for Economic Affairs SECO

ALBANIA

THE IMPACT OF

COVID-19-Related Budget Reallocations

1818 H Street NW, Washington DC 20433

Telephone: 202-473-1000; Internet: www.worldbank.org

1 2 3 4 15 14 13 12

This publication was produced with the financial support of the World Bank–State Secretariat for Economic Affairs (SECO) Sovereign Disaster Risk Financing and Insurance Program for Middle-Income Countries. Its contents do not necessarily reflect the views of the SECO.

The report was completed in September 2021.

Table of Contents

List of Tables

List of Figures

List of Boxes

Abbreviations

CBA	Cost-Benefit Analysis
COM	Council of Ministers
DLI	Disbursement-Linked Indicator
DRF	Disaster Risk Finance
EU	European Union
GDP	Gross Domestic Product
GOA	Government of Albania
IDRA	Institute for Development, Research and Alternatives
IMF	International Monetary Fund
MCF	Marginal Cost of public Funds
MOESY	Ministry of Education, Sports and Youth
MOFE	Ministry of Finance and Economy
MOHSP	Ministry of Health and Social Protection
MVE	Marginal Value of Public Expenditure
NATO	North Atlantic Treaty Organization
NCPA	National Civil Protection Agency
NGO	Non-Governmental Organization
OBL	Organic Budget Law
ODA	Official Development Assistance
PFM	Public Financial Management
SECO	State Secretariat for Economic Affairs (Switzerland)

Currencies: Albanian lek (lek), United States dollar (US$), euro (€).

Relevant-year annual average exchange rates are used throughout.

Acknowledgments

This report was prepared by a team led by Tatiana Skalon (Financial Sector Specialist) and comprising Stephanie Allan (Senior PFM Consultant), Dayna Connolly (PFM Consultant) and Fatma Jaupi (Senior PFM Consultant), all part of the World Bank Disaster Risk Financing and Insurance Program (DRFIP) of the Finance, Competitiveness, and Innovation Global Practice. David Bevan (Lead Economist, Emeritus Fellow, St. John's College, University of Oxford) provided invaluable guidance and quality assurance. Mark Minford (Lead Education Economist) led the development of the cost-benefit analysis. Evie Calcutt (Financial Sector Specialist) and Lisa Yu (Actuary Consultant) led the development of the disaster risk finance analysis. The report was developed in collaboration with Daniel Kull (Senior Disaster Risk Management Specialist), Johanna Jaeger (Senior Financial Sector Specialist), Alper Ahmet Oguz (Senior Financial Sector Specialist), Keler Gjika (Financial Sector Specialist), Flora Kelmendi (Senior Education Specialist), Hilda Shijaku (Senior Economist), Oraz Sultanov (Operations Officer), Anita Ellmauer-Klambauer (Urban Development Analyst) and Lewis Hawke (Lead Public Sector Specialist). The report was edited by Anne Himmelfarb.

The team wishes to express appreciation for the valuable comments received from peer reviewers Mediha Agar (Senior Public Sector Specialist), Mary Elinor Boyer (Disaster Risk Management Specialist), Samantha Cook (Senior Financial Sector Specialist), and Christoph Ungerer (Senior Economist); and for guidance from Emanuel Salinas Munoz (Country Manager for Albania), Mario Guadamillas (Practice Manager), and Olivier Mahul (Practice Manager).

The team gratefully acknowledges the data, information, and other invaluable contributions from representatives of the Government of Albania, including all interviewees noted in Annex A, with particular thanks extended to Gentian Opre, Director of Analysis and Budget Programming, and Xhoana Agolli, Director of Budget Management, Ministry of Finance and Economy.

Preparation of this reported was enabled with financial support from the World Bank–SECO Sovereign Disaster Risk Financing and Insurance Program for Middle-Income Countries.

Executive summary

Context

The fiscal impacts of disasters originate from both short- and long-term consequences, such as deteriorating fiscal balances, economic contraction, and increase in public debt. Beyond these costs, there are other ways in which disasters affect government budgets. For example, governments with constrained fiscal space or limited pre-arranged sources of funds (such as reserve funds or insurance) are forced to raid their existing budgets and reallocate funds to finance essential relief and recovery. While such actions are necessary, they crowd out other important planned public expenditures, presenting an opportunity cost in terms of forgone or delayed returns. Yet, across the world, budget reallocations are poorly documented and rarely quantified.

This analysis seeks to quantify the impact of such budget reallocations in Albania by examining how the Government of Albania (GOA) utilized them for financing the response to the COVID-19 pandemic. The analysis builds on the data recorded in the BOOST database[1], on data shared by the GOA, and on a series of interviews conducted with the Ministry of Finance and Economy (MOFE) and other line ministries and public agencies over the course of the pandemic. The analysis covers national government and subnational transfers in 2020.

Findings[2]

To finance the COVID-19 response in 2020, the GOA used a combination of budget reallocations (through virements and normative budgets), public sector borrowing, and the Council of Ministers (COM) Reserve Fund. Four normative budgets across 2020 were required in order to reallocate the budget due to the nature of the rapidly unfolding emergency (in non-emergency years, two to three normative budgets is typical in Albania, as a reflection of the country's strict virement rules). These budget reallocations were a relatively quick source of funds for the COVID-19 response, but this speed came at the cost of wider engagement with government institutions outside of the MOFE. Borrowing was also identified as a key source of financing; the public sector debt stock grew by lek 112 billion over 2020. Borrowing was possible at pace in part because rapid international financing was available, but also because the GOA had prepared for a Eurobond issuance ahead of the crisis and was able to augment and fast-track the issuance. Without this extensive borrowing, the budget reallocations would likely have been more severe. However, **Albania now faces challenges with debt sustainability;** its debt-to–gross domestic product (GDP) ratio reached 78 percent in 2020. The COM Reserve Fund was expanded significantly, but the expansion was done ex post and was overall insufficient in size for the emergency needs.

Budget reallocations were a key tool for the MOFE in addressing the costs of the pandemic (totaling lek 17.7 billion), although the amount reallocated would have been significantly larger if borrowing had not come online when it did. Spending by line ministries was lek 40.8 billion higher than the 2020 counterfactual—the estimates of what spending would have looked like in 2020 had the pandemic not occurred—but there were large areas of underspending. In total, **57 percent of budget programs experienced net underspending** compared to the counterfactual on account of COVID-19. Total underspending amounted to lek 17.7 billion, **equivalent to 93 percent of total COVID-19 expenditures** in 2020,[3] or 5 percent of total spending in 2020,[4] or 16 percent of additional net public debt taken on in 2020,[5] or 131 percent of total COVID-related outturns under the COM Reserve Fund. The largest amount of underspending occurred in the Ministry of Defense, MOFE, and Ministry of Education, Sports and Youth, together accounting for 43 percent of underspending. Underspending was largest in the goods and services category (a total of lek 5.7 billion), closely followed by capital spending, where underspending totaled lek 5.2 billion.

The analysis confirms that most budget reallocations are not free, and that above a certain level they impose a significant opportunity cost. Of the lek 17.7 billion underspent, analysis has deemed lek 9.9 billion was intended for viable expenditure (i.e. which could have reasonably gone ahead, had funding been available) and therefore incurs an opportunity cost when it is cut. At the aggregate level, the

1. World Bank Open Budget Portal, https://www.worldbank.org/en/programs/boost-portal.
2. The results of this analysis should be interpreted with some caution. The methodology applied is novel and requires further testing to refine and improve the results. The methodological annex should be referred to for further details.
3. The figure is for additional expenditure plus forgone revenue, not including below-the-line measures (see Box 1). This is not to imply that reallocations went to finance COVID-related expenditures. In a context of falling revenues, reallocations could also have been undertaken to protect other priority government spending not necessarily related to COVID-19.
4. Total spending comprises spending by line ministries, debt repayment, and transfers to local government.
5. This is for both COVID- and non-COVID-related purposes; more of the additional debt was needed to cover maturing debt from earlier years.

estimated value forgone associated with COVID-19-related budget reallocations in 2020 totals lek 12.3 billion (US$113 million), or 0.76 percent of GDP. This is modest when compared to the estimated direct impacts of COVID-19 on the economy (eight percentage points of GDP were lost compared to pre-COVID growth forecasts for 2020); but it is considerable when compared against the lek 19 billion spent on COVID-19 measures. Moreover, this estimate is sensitive to the underlying assumptions made in the analysis (for example, concerning the share of underspending which is deemed (non)viable, and estimates of the fiscal multiplier). Employing more and less conservative assumptions suggests a range in value forgone of between lek 8.7 billion and lek 15.4 billion (US$80 million – US$141 million). Most of the value loss was in the general public services, defense, education, and justice sectors.

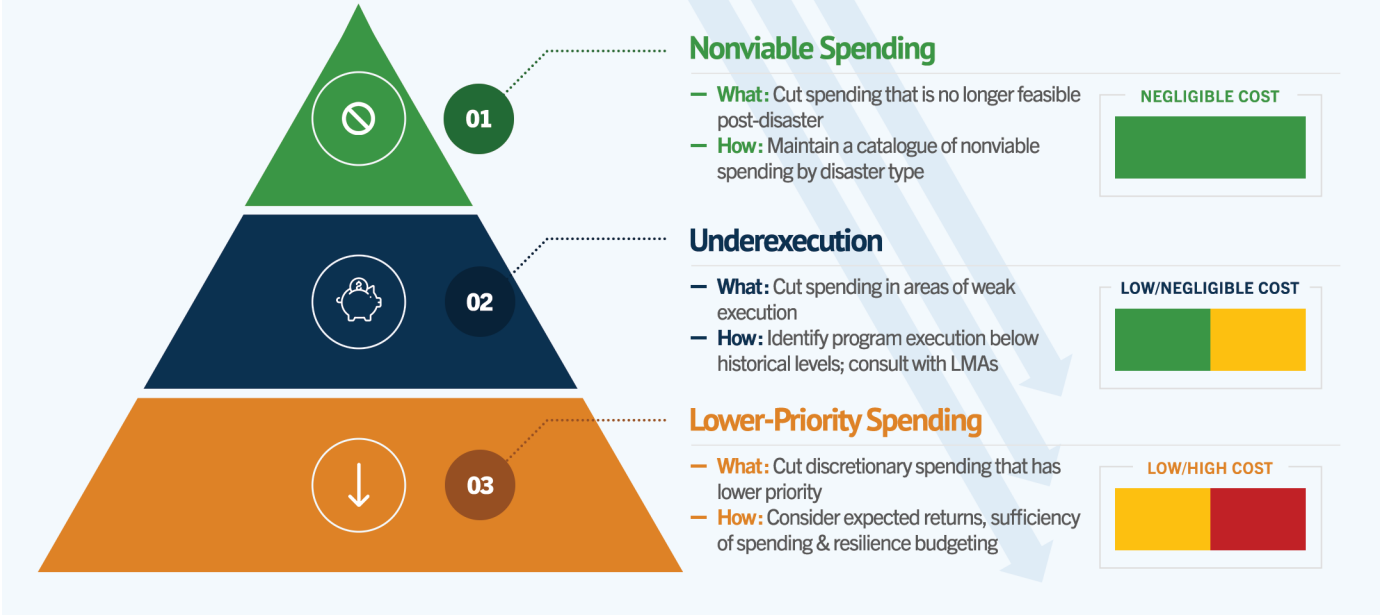
The more a government relies on budget reallocations, the more costly they are. The GOA was very astute in opting to cut nonviable (i.e., zero-cost) expenditures first. There is, however, a natural limit to such "free" cuts. After these initial cuts, subsequent cuts incur an economic cost that increases at a growing rate with the volume of cuts necessitated. Having exhausted all nonviable expenditure cuts, the GOA cut areas of projected underspending followed by lower-priority spending. This is in line with the recommended approach. However, to render the decision-making process more transparent and quicker, and provide line ministries with more predictability in relation to in-year budget changes, the GOA should consider formalizing criteria for budget cuts and agreeing with line ministries ex ante. The criteria should consider development priorities, projected returns of individual projects, and the underlying sufficiency of spending in different sectors.

Recommendations

To improve budget credibility in the face of future disasters or shocks, the GOA should consider two key measures that would lessen its reliance on ex post sources of financing, while also making the use of budget reallocations more cost-efficient:

1. **Adopt a framework for approaching disaster-related budget reallocations ex ante.** Although budget reallocations are fast in Albania, the convenience they offer needs to be carefully balanced against the lack of engagement from line ministers and subsequent risk to budget credibility during (and beyond) crises, as well as the opportunity cost they incur. The government should consider developing a framework for budget reallocations that includes shifting budget reallocations from a rushed ex post instrument to a pre-planned ex ante instrument by pursuing some of the options set out in Figure ES1. Implementing such a framework would facilitate greater engagement with line ministries, greater scrutiny from Parliament, and a more credible budget.
2. **Develop a more comprehensive approach to financing post-disaster needs.** A proactive approach to budget reallocations should be couched within a broader disaster risk financing strategy to ensure that the costs and benefits of such an approach are weighed against other available financing tools, such as risk transfer instruments and a cost-effective use of domestic public finance. At present, the GOA has a number of approved instruments that are yet to be established and operationalized, and nearly all of the risk remains on the GOA's balance sheet because limited risk transfer tools are available. This leaves Albania's public finances vulnerable to shocks; a comprehensive approach to disaster risk financing could help to identify the most cost-effective and timely way to mitigate this vulnerability.

ES1. Framework for approaching disaster-related budget reallocations



Source: World Bank.; Note: LMAs = line ministries and agencies.

Introduction 1

1.1 Purpose of the report

Relying on budget reallocations to finance emergency response and recovery can present substantial opportunity costs to governments. The fiscal impacts of disasters originate from both short- and long-term disaster impacts and include deteriorating fiscal balances (through decrease in revenues and increase in expenditures), economic contraction (through loss of lives and assets), and increases of public debt. Governments with constrained fiscal space or limited pre-arranged risk financing instruments (like reserve funds or insurance) are forced to raid their existing budgets in order to finance essential relief and recovery. While necessary, this approach crowds out other important public expenditure, presenting an opportunity cost in terms of forgone or delayed returns.

The opportunity cost of post-emergency budget reallocations is widely acknowledged but rarely quantified. Studies in disaster risk finance (DRF) frequently mention the opportunity cost of diverted funding when discussing indirect costs of disaster, but rarely unpack it. For example, the seminal Financial Protection against Natural Disasters (World Bank 2014) observes that "long-term development prospects suffer as the government diverts public funding from social and economic development programs" (18–19) and warns that this can "endanger development programs that often take many years of preparation" (32). While these assertions appear self-evident and are widely supported anecdotally by country experiences, there is very little quantitative evidence on the role and scale of budget reallocations, including the long-lasting effects on economic growth and development. A study by Benson and Clay (2004) takes a look at this question and offers some preliminary estimates of the scale of budget reallocations, but offers no insight into the longer-term economic or social impacts. More recently, a Public Expenditure Review of disaster-related expenditures in the Philippines highlighted challenges in tracking and quantifying budget reallocations and recommended to monitor reallocations moving forward; it argues that without such monitoring, the government is likely to underestimate total disaster-related spending (World Bank 2020c). The reason that questions about the scale and impact of budget reallocations have been left unanswered is that disaster-driven reallocations are typically poorly documented. What decisions were made and why is often forgotten once a crisis abates, and this information cannot always be determined ex post through a review of routine budget data, which tend to present outturn data in aggregates, thus hiding movements at lower levels of detail.

The analysis presented in this report aims to (i) support the efforts on DRF in Albania; and (ii) make a contribution to the global evidence base on the cost of disasters, specifically focusing on the costs and benefits of using ex post public budget reallocations as a financing instrument for disaster-response. Albania is vulnerable to a variety of natural disasters, such as earthquakes, floods, landslides, and others. In 2019, the country faced a major earthquake (preceded by another more minor one), which caused combined damages and losses of over US$1.1 billion (EU et al. 2020), and it soon after had to face the COVID-19 pandemic. However, the government lacks a comprehensive approach to risk financing and relies extensively on ex post risk financing instruments, including budget reallocations. This analysis began in 2020, focusing on the financial management of the ongoing COVID-19 pandemic, which offered an opportunity to study budgetary decision-making in real time. The pandemic's far-reaching spread allowed for cross-country learning; similar research on budget reallocations for COVID-19 are being conducted in Pakistan, South Africa, and Ethiopia through the UK's Foreign, Commonwealth & Development Office and the Centre for Disaster Protection, and the different country cases studies informed each other.

This analysis was prepared at the request of and in close collaboration with the Ministry of Finance and Economy (MOFE) of Albania. It aims to provide MOFE with a more complete understanding of the costs of relying on reallocations, which could inform development of a more comprehensive approach to DRF. It could, for example, guide the selection of new financing instruments to ensure sufficient and timely financing is available when the next disaster hits, so that routine government budgets are not impacted or subject to cuts. Additionally, the report offers a framework for approaching post-disaster budget reallocations in the future, in an effort to maximize their benefit and limit associated costs (Chapter 5).

1.2 Context

Albania is vulnerable to disasters that posed a significant source of fiscal risk to the Government of Albania (GOA) even before the pandemic. Albania has among the highest levels of disaster risk in Europe according to the World Risk Index (Bündnis Entwicklung Hilft and IFHV 2019); its most frequent and costly hazards are floods and earthquakes. In 2010 floods affected nearly 2,500 households, causing damage to water supply, arable lands, and transport infrastructure amounting to US$51 million (0.4 percent of the 2009 gross domestic product [GDP]). In November 2019 a major earthquake caused damages and losses equal to 7.5 percent of GDP (World Bank 2020a). In January 2021, prolonged heavy rains and above-average temperatures resulted in flooding in the north of the country that left over 7,000 hectares of land under water, damaging public assets and necessitating the evacuation of some residents (Floodlist 2021).

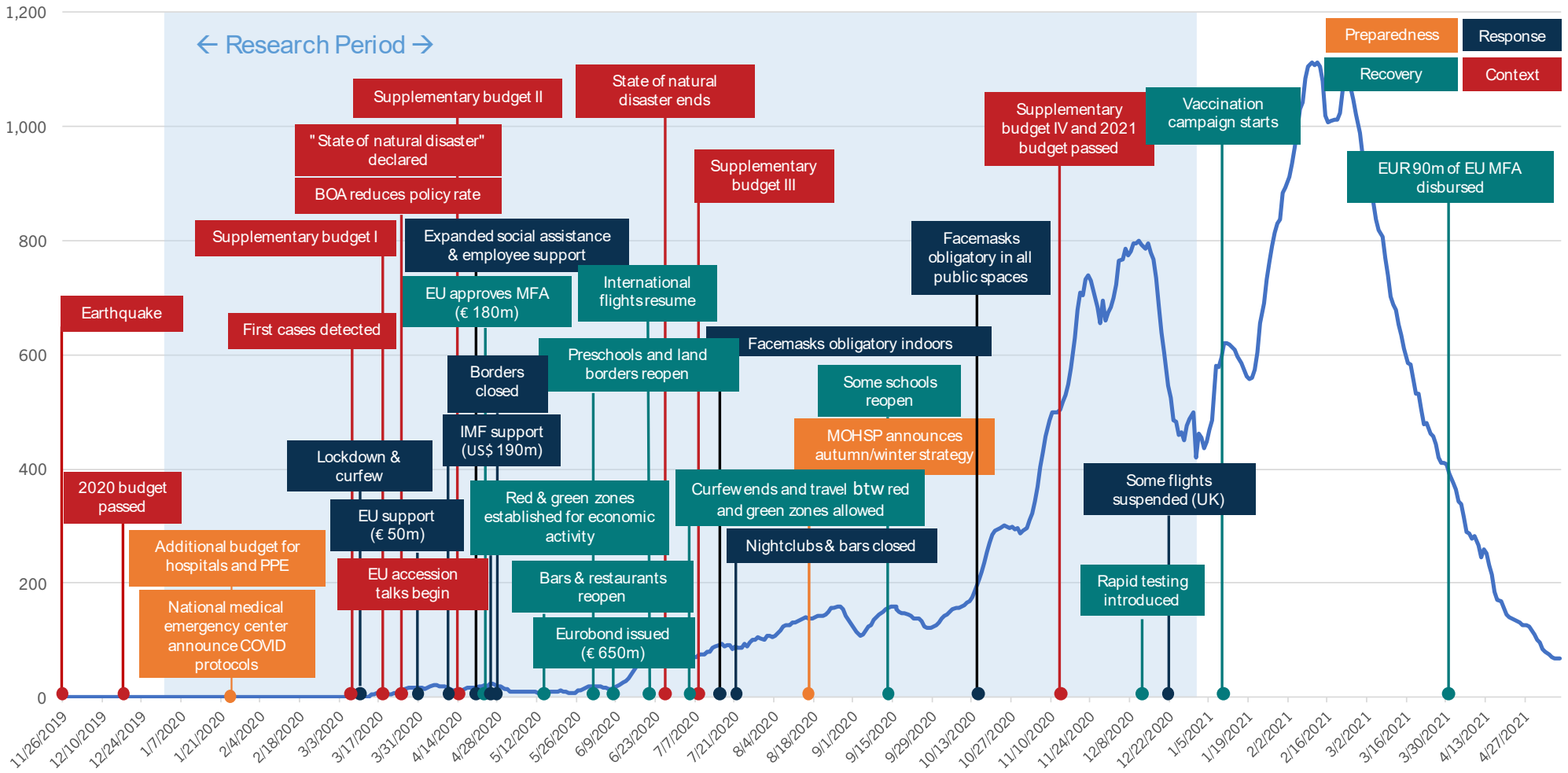
Responsibility for civil protection is devolved to local governments until the response exceeds local capacities. According to the Law on Local Self-Government (2015), civil protection is a responsibility of the local governments. This is reiterated in the Law on Civil Protection (2019), where the principle of subsidiarity states that "when in a natural or other disaster, protection, rescue and assistance are required, the capacities of the local government unit affected by the disaster, shall be used first. It is only when local government capacity is exhausted that neighboring local governments and national government institutions can be mobilized" (National Assembly 2019). For major disasters that involve the declaration of a state of natural disaster, the national government plays a leading role. The Constitution gives the right to declare a state of natural disaster to the Council of Ministers (COM), and the declaration can be in force for up to 30 days (thereafter, it can be extended by the National Assembly).

Disasters are both an explicit and implicit contingent liability for the GOA. The Law on Civil Protection specifies that the Albanian state is liable for damages caused by the consequences of a disaster (National Assembly 2019). It specifies that the municipality civil protection fund is the entity responsible unless the compensation exceeds 8 percent of the municipality budget; then the compensation may be financed by the National Civil Protection Agency (NCPA). The compensation amount, along with the procedure and time frame for payment, is approved by the COM. There is no explicit cost-sharing arrangement for reconstructing public assets and infrastructure; the decision is likely made ad hoc and is the responsibility of the asset owner (World Bank 2020a). In addition, the government might be morally required to support affected businesses and the financial sector in case of a major disaster.

Albania's first peak of infections started in December 2020, followed by a second peak in February 2021. The first case of COVID-19 was registered in Albania on March 8, 2020, and by the end of 2020, there had been a total of 58,318 confirmed cases. This is equivalent to 20,264 cases per million. The first peak of daily new infections in mid-December 2020 reached 800 cases per day. This was followed by a stronger peak in February 2021 that reached 1,239 cases per day; but new infections were below 100 for the month of May, and as of June 2021 the country seems to be squarely in recovery mode (see Figure 1).

In response to the pandemic, the GOA adopted a series of containment measures in early March 2020, including lockdowns and travel restrictions that were gradually rolled back from mid-May 2020. Public health measures included closure of public places (such as schools and restaurants), introduction of curfews (varying by green and red zones, depending on infection rates), closure of land and sea borders, and limits on air travel. The GOA formally declared a state of natural disaster on March 24, 2020, and it remained in place until June 23, 2020. The strictest measures were gradually loosened from late April 2020; see Figure 1 for the timeline of key events.

Figure 1. Timeline of key events and daily new COVID-19 cases, Albania



Source: Based on OECD 2021.

Note: BOA = Bank of Albania; MFA = macro-financial assistance; MOHSP = Ministry of Health and Social Protection; PPE = personal protective equipment.

As a result of the pandemic, the economy—still reeling from the earthquake four months earlier—has taken a sizable hit. The November 2019 earthquake was projected to slow down economic growth in 2020 by 0.5 percentage points compared to earlier forecasts, and to increase the fiscal deficit by an additional 0.7 percent of GDP because of increased expenditures to finance reconstruction and a reduction in revenues (World Bank 2020a). Just months later Albania's economy was hit by the global COVID-19 pandemic, with the latest forecasts estimating that Albania's economy shrunk by 4.7 percent in 2020, equivalent to 8.1 percentage points below pre-COVID forecasts for the year, and 6.9 percentage points below 2019 growth levels (World Bank 2020b, 2021a). This was largely the result of a slowdown in services (-8.1 percent) and industry (-2.1 percent) linked to the recession in the European Union (EU), supply chain disruptions, travel limitations, and social distancing measures.

Albania made efforts to mitigate the impact of the pandemic through a sizable fiscal stimulus, pushing up the fiscal deficit to 7.0 percent of GDP. In the initial 2020 budget, the fiscal deficit was estimated at 2.2 percent of GDP; the sizable jump of an additional 4.8 percentage points reflects lower revenue (16 percent down from original forecasts) and increased spending needs for both shocks, leaving Albania in its largest fiscal deficit in over a decade (see Table 1). Albania's stimulus package in 2020 included a number of budgetary measures (additional expenditures and forgone revenues) totaling lek 19 billion, and some below-the-line measures (guarantees and other contingent liabilities) totaling lek 26 billion (IMF 2021). Box 1 describes the measures included in the stimulus package. Albania financed its fiscal stimulus through a combination of budget reallocations, borrowing, mobilization of reserve funds, and official development assistance (ODA). Section 3.2 discusses the different mechanisms utilized to finance Albania's fiscal stimulus package in more detail; here it is enough to note that a large share was financed through external debt. This pushed Albania's public debt–to-GDP ratio to 78 percent and undid the successful declining trend of debt in recent years. While Albania still has relatively good access to markets, its debt path is subject to significant risks and its gross financing requirements remain large, leaving Albania with limited fiscal space in the absence of expanded revenue collections.

Currently, forecasts suggest a return to modest growth of 4.4 percent in 2021, driven by a partial rebound in exports and consumption and government-led reconstruction investment. Yet there continues to be significant uncertainty. How long these impacts last will be determined in large part by the duration of the pandemic, the rollout of the vaccine, and any further shocks. The recent DRF diagnostic (World Bank 2020a) cautioned that the compounding effect of a pandemic following an earthquake renders Albania acutely vulnerable to any other disasters that may befall it in the near term.

Table 1. Key macro-fiscal indicators →

(annual percentage change except where indicated)	2019	2020	2021	2022
		Estimate	Forecast	
Real GDP growth	2.2%	-4.7%	4.4%	3.7%
Agriculture	0.4%	1.7%	1.7%	1.5%
Industry	1.8%	-2.1%	6.9%	5.0%
Services	3.1%	-8.1%	4.1%	3.8%
Gross fixed capital investment	-3.3%	-7.1 %	5.4%	-4.6%
Exports, goods and services	6.0%	-30.6%	20.5%	13.7%
Current account balance (% GDP)	-8.0%	-9.3%	-8.8%	-7.4%
Fiscal balance (% GDP)	-2.0%	-7.0%	-5.5%	-4.1%
Public debt (% GDP)	67.9%	77.9%	79.5%	78.8%
Headcount poverty ratio[a]	32.0%	33.0%	31.7%	

Sources: World Bank 2021a – latest forecast as of Spring 2021 (more recent data suggests a stronger GDP rebound in 2021); MOFE website, https://www.financa.gov.al/.

a. Upper-middle-income country poverty rate (US$5.5 in 2011 purchasing power parity).

Box 1. Fiscal measures introduced in response to COVID-19

The government approved three support packages across 2020 for individuals and businesses affected by the COVID-19 pandemic, with on-budget measures totaling lek 19 billion in 2020, equivalent to 1.7 percent of GDP.

These packages included measures for additional health spending, specifically on the following:

- Additional medical equipment
- Personal protective equipment
- Bonuses for frontline health care workers dealing with COVID-19
- Establishment of new quarantine centers

The packages also included additional spending for individuals and businesses:

- From April to June, unemployment benefits and social assistance layout were doubled, while support was offered to small businesses/self-employed individuals forced to close activities due to the pandemic (minimum wage of lek 26,000 per month) and to people in family businesses with declared but unpaid family members on the payroll, for up to two minimum wages.
- There was a one-time transfer of lek 40,000 to affected people in the tourism sector, active processing sector, and employees of small businesses not already covered by existing support, including employees of large businesses who were laid off due to the pandemic.
- An additional minimum wage was paid to public transport workers who started work one month later than the removal of restrictions for the rest of the economy.
- Annual indexation of pensions to consumer price index, usually applied in July, was brought forward to April. Pensions were increased by 2.3 percent effective April 1.

The government also adopted some tax deferral and tax-forgoing measures:

- All large companies (except banks, telecommunication firms, state-owned enterprises, and companies in the supply chain for essential goods) were able to defer their corporate income tax payments for Q2 and Q3 2020 for one year (i.e., to Q2 and Q3 2021).
- For the tourism sector, active processing sector, call centers, and small businesses with turnover of lek 14 million or less, the payment of Q2, Q3, and Q4 2020 profit tax was deferred for one year.
- Small businesses, defined as those with an annual turnover below lek 14 million, were not required to pay profit tax in 2020 (normative act April 23).

In addition, the packages introduced in 2020 had a number of below-the-line measures totaling an additional lek 26 billion. This covered a lek 11 billion sovereign guarantee allowing large businesses to tap overdraft or credit lines in the banking sector to pay worker salaries. The GOA guaranteed 100 percent of the principal and directly covers interest costs, with interest rates capped at 2.85 percent and maturity up to two years, with a three-month grace period on principal. Furthermore, lek 15 billion was provided for an additional unfunded sovereign guarantee line to enable loans for working capital and investments. All private companies that were tax compliant and creditworthy prior to the pandemic were eligible. The government guarantee covers only 60 percent of the principal, the loan maturity up to five years, interest rates capped at 5 percent, individual loan limits of lek 300 million, and six-month grace periods on repayment of principal.

Source: World Bank based on IMF 2021.

1.3 Outline of this report

The rest of this report is structured as follows:

- Chapter 2 touches on the methodology used for the analysis, including the research questions it seeks to answer (further details can be found in Annex B).
- Chapter 3 presents the findings in relation to the questions.
- Chapter 4 offers some conclusions.
- Chapter 5 provides a recommended framework for approaching disaster-related budget reallocations.
- Chapter 6 recommends areas for further research.

Overview of the methodology 2

The overarching question this report seeks to answer is:

How has COVID-19 changed public expenditure in Albania, and what is the impact of budget reallocations?

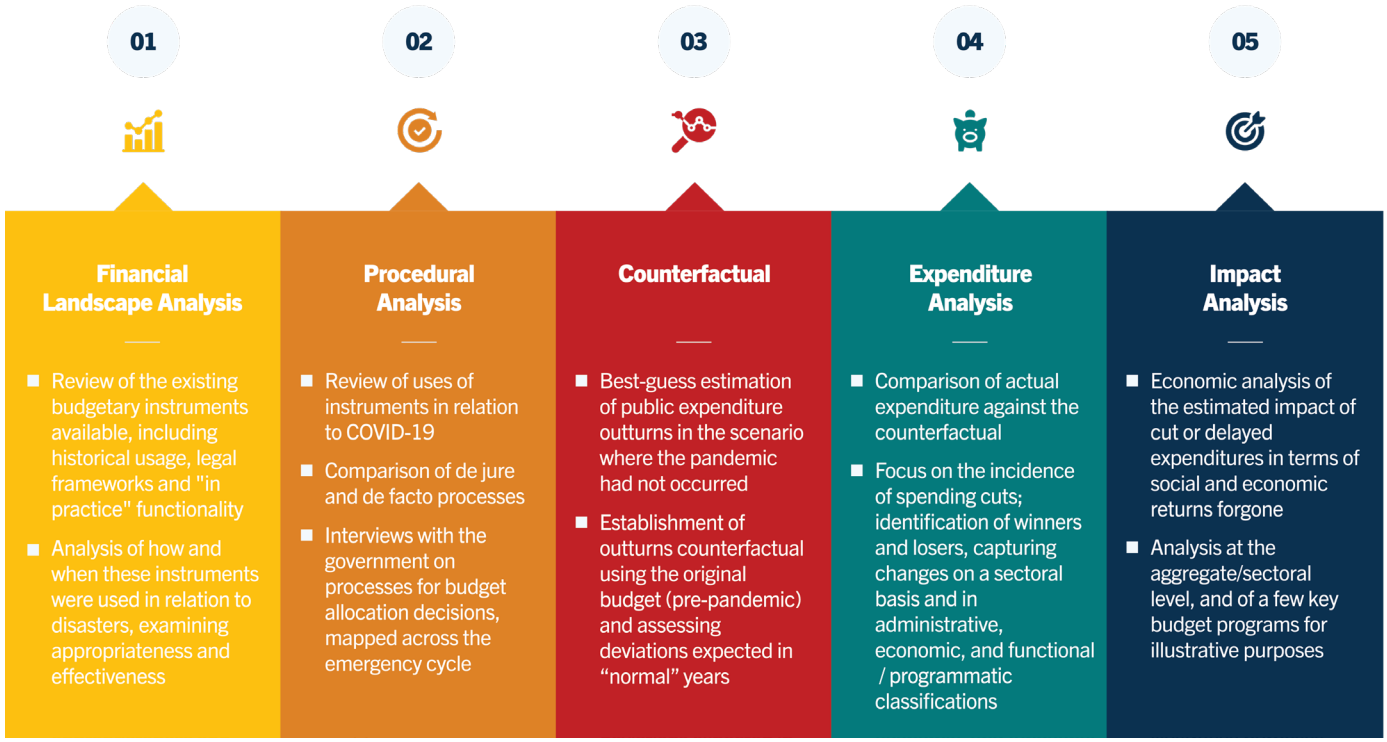
The answer is arrived at by addressing four subsidiary questions:

1. What budgetary instruments (ex ante and ex post) are in place to respond to disasters; and how effectively did they function in the case of COVID-19 in 2020?
2. What formal laws and processes govern budget reallocation decision-making? Were they followed in wake of COVID-19? What informal criteria guided decision-making?
3. How has public expenditure deviated from existing plans on account of COVID-19?
4. What has been the broader impact (in terms of opportunity cost) of these budget reallocations?

This analysis is focused on national government because (i) the majority of spending occurs at this level (83 percent); (ii) the target audience is the central Ministry of Finance and Economy; and (iii) once a state of natural disaster is declared, as it was for COVID-19, the legal framework stipulates a leading role for the national government.[6] This is not to deny the impact on subnational finances, nor the likely use of reallocations at that level (particularly in light of reduced borrowing prospects); and further research at subnational level is proposed in chapter 6. Furthermore, the report is focused only on 2020 (in Albania, the fiscal year aligns with the calendar year), although the fiscal impacts of COVID-19 are likely be felt beyond this time frame.

To answer the above questions, a five-pillar methodology was developed, as set out in Figure 2. Annex B contains details on the methodology for each of the pillars.

Figure 2. Methodological pillars



Sources: World Bank; Centre for Disaster Protection.

6. The analysis focuses on national government—that is, the main 44 line ministries and agencies in Albania. The study excludes spending by local governments and spending by the special funds (the Social Security Institute, Health Insurance Institute, and Former Owners Compensation Fund). Transfers to such entities are included within the analysis.

Findings 3

3.1 Summary of research questions and key findings

Question 1: What budgetary instruments (ex ante and ex post) are in place to respond to disasters; and how effectively did they function in the case of COVID-19 in 2020?

- For financing COVID-19 response in 2020, the GOA used the following budgetary instruments: (i) budget reallocations (through virements and supplementary—i.e., "normative"— budgets), (ii) public sector borrowing, and (iii) the Council of Ministers Reserve Fund. The last of these was the only ex ante financing instrument in use (others were identified, but these were either not operational at all, or not used for COVID-19).
- Normative budgets—four in 2020—enabled more substantive reallocations than virements. While such budgets can be prepared relatively quickly in Albania, their use comes at the cost of wider engagement with government institutions outside of the MOFE and entails a lack of transparency.
- Public sector borrowing grew by lek 112 billion over 2020, providing additional liquidity. Funds were accessed quickly, in part because rapid international financing (from the International Monetary Fund) was available and because the GOA had made advance preparations for a Eurobond issuance ahead of the crisis; the GOA was able to fast-track the issuance and tack on additional financing needs. Without this extensive borrowing, the budget reallocations would likely have been more severe. However, Albania now faces challenges with debt sustainability (with the debt-to-GDP ratio reaching 78 percent in 2020).
- The COM Reserve Fund was expanded significantly to finance lek 15.4 billion of COVID-19-related expenditures (from an initial allocation of only lek 1.7 billion). It was quick to disburse and accountable to Parliament, but overall insufficient in size for the emergency needs.

Question 2: What formal laws and processes govern budget reallocation decision-making? Were they followed in the wake of COVID-19? What informal criteria guided decision-making?

- The legal framework specifies differing criteria for virements for different expenditure classes; these are strict compared to criteria in other countries. The processes are followed in practice, but timelines were condensed in the emergency. Most reallocations can be formulated, approved, and implemented in less than a week when needed.
- The process for compiling a normative budget is less well specified in the legal framework. In practice it usually takes up to a month, in a process led by MOFE with varying levels of engagement of line ministries. In 2020, there were four normative acts, and two of them were fast-tracked to take a week in response to the pressing needs of the emergency.
- The first two normative acts emphasized cuts to salaries and nonviable operational budgets, although cuts to capital were also needed. This step freed up resources for the COM Reserve Fund, MOFE, and Ministry of Health and Social Protection. The third normative act cut capital across the board based on execution performance, and extra money went to reconstruction and reinstating some of the earlier cuts. The fourth normative act was procedural, mainly driven by the need to carry over unused resources.

Question 3: How has public expenditure deviated from existing plans on account of COVID-19?

- Although spending by line ministries was lek 40.8 billion higher than the counterfactual in 2020, there were large areas of underspending too.
- In total, 57 percent of budget programs experienced net underspending compared to the counterfactual on account of COVID-19, totaling lek 17.7 billion.
- Underspending was most prevalent in items classified as goods and services (lek 5.7 billion, equivalent to 15 percent of actual expenditure on goods and services), closely followed by capital spending, where a total of lek 5.2 billion (or 8 percent of actual) was recorded against the counterfactual.

Question 4: What has been the broader impact (in terms of opportunity cost) of these budget reallocations?

- Of the lek 17.7 billion underspent, approximately lek 7.8 billion is associated with cutting expenditures that were rendered nonviable by the pandemic. The remaining lek 9.9 billion incurs an opportunity cost when it is cut. At the aggregate level, the estimated value forgone associated with COVID-related budget reallocations in 2020 totals lek 12.3 billion (US$113 million). This is modest when compared to the estimated direct impacts of COVID-19 on the economy (eight percentage points of GDP were lost compared to

pre-COVID forecasts), but considerable when compared to the lek 19 billion spent on COVID-19 measures. Moreover, the estimate is sensitive to the underlying assumptions made in the analysis (for example, concerning the share of underspending which is deemed (non)viable, and estimates of the fiscal multiplier). Employing more and less conservative assumptions suggests a range of value forgone of between lek 8.7 billion and lek 15.4 billion (US$80 million – US$ 141 million). Most of the value loss was in the general public services, defense, education, and justice sectors.

- Project-level accounts of the impact of cuts serve to demonstrate the different channels by which budget reallocations can undermine the achievement of project objectives, and can have potential knock-on implications for project performance, contingent donor financing, and the realization of sector plans.

3.2 Question 1: What budgetary instruments (ex ante and ex post) are in place to respond to disasters; and how effectively did they function in the case of COVID-19 in 2020?

Most of the instruments available to finance COVID-19 in Albania were ex post in nature and included budget reallocations, public sector borrowing, and ODA. These instruments were mobilized only after the COVID-19 pandemic was a realized threat. Budget reallocations were quick, however, with line ministries such as health instigating virements in the very early days of the pandemic, and the MOFE passing its first normative budget act in mid-March—just 11 days after the first case was detected. Borrowing is a routine part of financing expenditures in Albania, and this approach was used throughout the pandemic, with some larger foreign debt instruments (e.g., the Eurobond) fast-tracked and augmented to respond to additional COVID-19 needs. Official development assistance is small in Albania and generally slow (aside from some purpose-designed rapid instruments).

Only one ex ante instrument was used for COVID-19, the COM Reserve Fund. Disbursement decisions for the fund were made and enacted quickly—so fast that the fund was exhausted shortly after being capitalized. However, most of the COVID-19 financing from the reserve fund was allocated through normative budgets after the crisis hit, so in effect it also amounted to an ex post instrument. Other ex ante risk financing instruments for financing disasters were identified but were either not operational in 2020 or not used for COVID-19 purposes (see Box 2). They are therefore excluded from the analysis.

Box 2. Risk financing instruments in Albania not used for COVID-19

The 2019 Law on Civil Protection sets the legal foundation for a disaster fund under the National Civil Protection Agency (NCPA), the Solidarity Fund. By the end of 2020, **the Solidarity Fund** had not been established or capitalized, and this continues to be the case in 2021. The Law on Civil Protection also requires certain line ministries to set aside 2–4 percent of their annual budget for **disaster risk reduction and response contingencies**, but these were also not found to be in place as of 2020, and MOFE did not enforce this provision, citing the potential opportunity cost and allocative efficiency challenges associated with idle funds in the budgets of multiple agencies.

There is also a **Contingency Fund for Debt Risk** that is used to compensate for exchange rate and interest rate fluctuations. It was not available to finance COVID-19 response and recovery directly. However, the additional debt burden and the depreciation in the current account balance arising from crises could lead to increased demands on the fund.

The **Reconstruction Fund** was established in Normative Act 9, On Addressing Natural Disaster Consequences, to finance recovery and reconstruction after the 2019 earthquake. It combines government and donor resources for purposes of reconstruction and aid to affected households and business. Funding under the Reconstruction Fund cannot vary from this purpose and so was not available for financing COVID-19 response.

It is possible to finance disasters through the buildup of **arrears** (i.e., procuring goods and services but delaying payment). Given accounting conventions, the presence of increasing arrears may lead to an underestimation of expenditure, and correspondingly an underestimation of the true impact of government interventions and the size of the fiscal problem facing a country. However, overall, Albania's stock of arrears fell over the course of 2020 (from lek 28.1 billion to lek 23.8 billion), and only two agencies registered an increase in arrears: MOFE, due to court decisions under the General Directorate of Taxation, and the Ministry of Defense, in relation to reconstruction spending under the NCPA. In other words, none of the increases were related to COVID-19 (MOFE 2021a).

Sources: World Bank; MOFE 2021a.

With little in the way of risk transfer instruments, the Government of Albania retained most of the fiscal costs of the pandemic. The only instrument that transferred costs off the government balance sheet was ODA, and most of that was provided as a loan given Albania's level of income, with only negligible amounts of grant funding. [7] Borrowing, budget reallocations, and the COM Reserve Fund are all ultimately financed by Albanian tax payers. There are no risk transfer instruments such as sovereign insurance for disaster risks or catastrophe bonds.

The rest of this section discusses the three budgetary instruments used to finance the pandemic response—namely, budget reallocations, borrowing, and the COM Reserve Fund. A summary of the key findings is in Table 2.

3.2.1 Budget reallocations

Budget reallocations take two forms: virements and normative budgets. Virements move funds between budget lines, usually in a way that does not substantially overhaul the nature of public expenditure, and they therefore do not need parliamentary approval as a new budget would. More substantive changes to the budget, including changes that affect the overall budget envelope and fiscal deficit, require a normative budget act to be passed by parliament. The provisions for virements are established in the Organic Budget Law (OBL) (National Assembly 2008, 2016), which provides comparatively strict limits for line ministries and budget institutions (in short, they have authority to move their budget around without MOFE or COM approval only for recurrent spending within a single program). Where a change exceeds 10 percent of a program value, the change requires a normative budget to be prepared.

Both virements and normative budgets were widely in use in 2020. As will be detailed under the response to question 3 (Section 3.4), budget reallocations associated with COVID-19 in 2020 stood at lek 17.7 billion, which is the total value of program-level underspending due to COVID-19. This total includes reallocations through virements, as well as the four normative budget acts passed over the course of 2020 (the expenditure analysis cannot distinguish what share came from virements versus normative budgets). [8] While two to three normative budgets are commonplace in Albania, the passage of four in 2020 was attributed to the pandemic. In general, excessive use of supplementary budgets in non-emergency contexts is indicative of weaknesses in budgeting, and furthermore it creates uncertainty for line ministries who cannot be confident that the amounts appropriated to them in the annual budget will be realized.

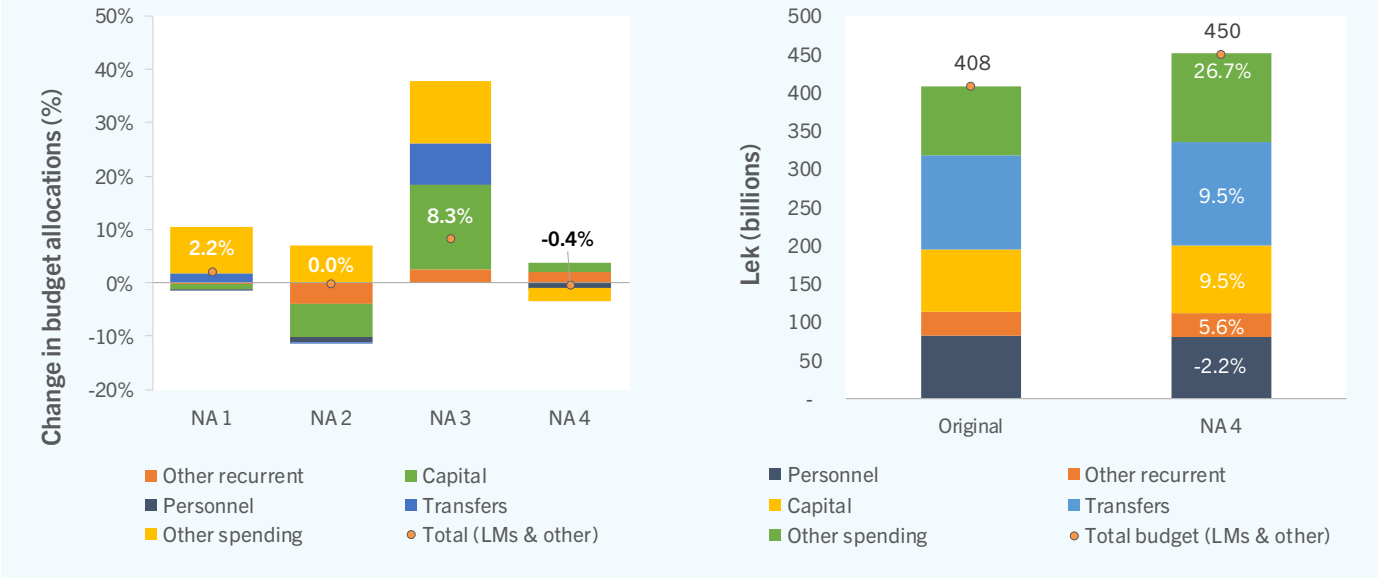
The first two normative budgets were important for financing early relief phase activities, while the third reinstated some of the earlier cuts once additional financing came on board; the fourth—coming late in the fiscal year—reallocated funds from ministries that are unlikely to spend them. A summary of the changes introduced through each normative budget is as follows:

- The first normative budget was approved on March 19, following the national lockdown announced on March 10, and increased the overall ceiling (for the entities included within the analysis) by 2.2 percent, or lek 9 billion (see Figure 3). The majority of this increase went to "other spending" [9]; more specifically, lek 8 billion went to the COM Reserve Fund before being allocated to wage and social support related to the COVID-19 pandemic. Budget cuts were made in some line ministries and budget institutions (largely through canceling unfilled vacancies) in order to reallocate funds to others; however, very few ministries were affected by the first supplementary budget in Albania.
- The second normative budget passed a month later (April 15), and while the ceiling remained unchanged, this budget moved money away from the line ministries and budget institutions (amounting to lek 7 billion) and increased other spending in the form of the COVID-19 window under the Reserve Fund, which was topped up by lek 7 billion (discussed below). This move reflected increased uncertainty, with the MOFE identifying areas to cut early on in anticipation of requiring the funds for additional COVID-19 response measures. To finance these additional measures, the second normative budget introduced broad cuts to all but a few institutions. Cuts went beyond canceling unfilled vacancies to also cover operational expenses and capital. This led to a further 6.1 percent reduction in the capital budget, 3.9 percent reduction in other recurrent expenditure, and 1 percent reduction in the personnel budget, compared to the first normative budget.

7. COVID-19-related grants committed in 2020 totaled €60 million, including support for strengthening of health systems (€4 million), social protection support (€11 million), and economic recovery assistance (€35 million) from the EU, as well as support for small and medium enterprises from Germany (€10.5 million). Of these grants, only the EU health system support was disbursed in 2020. Loan financing from the EU, IMF, and World Bank totaled €436 million, of which €170 million from the IMF (US$190.5 million) was disbursed in 2020.
8. Normative acts will appropriate any virements made up to that point in the fiscal year, meaning it is not possible to distinguish between new reallocations introduced in the act, and virements that predate it. The BOOST data do not distinguish virements and do not include all four normative acts; only the original and revised budgets are included. The research team was also unable to secure a comprehensive list of virements from GOA (which in any case would not have been complete, given that some virements remain under the auspices of the line ministries and do not need to be reported to central government). Nonetheless, it is reasonable to assume, in light of the relatively tight restrictions around virements, that the majority of the budget reallocations came through normative budgets. The "other spending" category includes interest payments, contingency funds, the COM Reserve Fund, transfers to local government, and the Reconstruction Fund.
9. The "other spending" category includes interest payments, contingency funds, the COM Reserve Fund, transfers to local government, and the Reconstruction Fund.

- The GOA moved toward the recovery phase for the first wave of the COVID-19 pandemic toward the latter part of April, reopening sectors of the economy across May and June, and ending the state of emergency on June 23. Alongside these steps, the third normative act, approved on July 2, aimed to support economic recovery, increasing the overall ceiling by 8.3 percent (lek 35 billion). This was possible due to increased access to external financing (described in Section 3.2.2). In addition to reinstating some of the earlier capital cuts, this budget allocated additional financing to the Reconstruction Fund, under "other spending," which was needed because previously pledged loans for reconstruction were taking longer than expected to materialize.
- A fourth normative budget, passed late in the fiscal year (December 16), again maintained the overall ceiling but reallocated funding away from ministries that were unlikely to spend it by the end of the year (including the Albanian Development Fund and the Ministry of Justice) and reallocated it, either to the next fiscal year as carryovers or to ministries with the capacity to spend the additional funds—i.e., Ministry of Infrastructure and Energy and Ministry of Health and Social Protection (MOHSP). Comparing the original with the final normative budget shows that total allocations to line ministries and budget institutions and "other spending" by the national government grew by 10 percent, or lek 42 billion.

Figure 3. Changing composition of budgets across 2020



Source: World Bank utilizing MOFE 2020.
Note: NA = Normative Budget Act; LM = line ministry. Percentages in righthand figure refer to percentage change for different categories of expenditure between the original and fourth normative budget act.

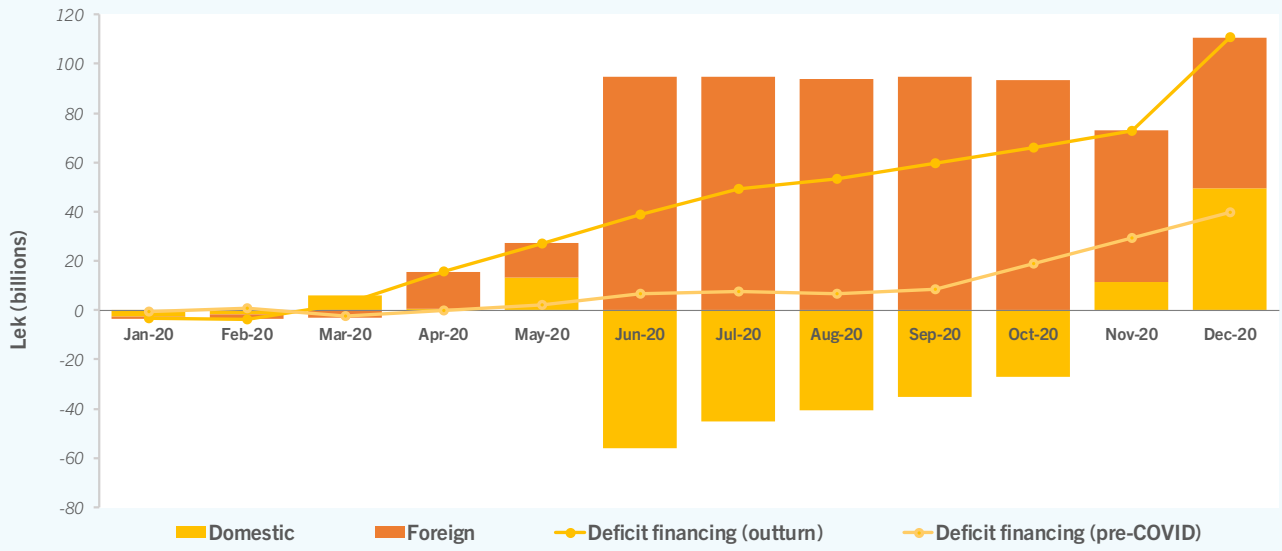
The primary advantage of budget reallocations as a financing mechanism in Albania is their speed, yet this pace comes at the cost of wider engagement with government and undermines budget credibility. Before additional significant liquidity can be secured, budget reallocations offer a mechanism for freeing up and channeling funds to priority needs. Compared to virements, which offer relatively limited flexibility in Albania, normative budgets permit more substantive changes to spending plans (which are needed following large-scale emergencies). Furthermore, the ability to fast-track procedures for compiling normative budgets (detailed under the response to question 2 in Section 3.3) renders them relatively quick instruments (they can be prepared and approved in less than a week), and so normative budgets provided a key funding source for the government's response and early recovery activities. However, normative budgets have some drawbacks. The first is that their speed may come at the cost of wider engagement with government institutions outside the MOFE, which can undermine budget credibility. This is regarded as a necessary trade-off by MOFE. The second is that without additional deficit financing, the reallocation of potentially significant volumes of funding away from their intended purpose can present a significant opportunity cost. This is the subject considered under question 4 (Section 3.5).

3.2.2 Public borrowing

Borrowing was critical to finance the growing deficit in 2020. In order to make up some of the shortfalls in revenue, the government turned to borrowing, increasing the size of the fiscal deficit by lek 70.7 billion, or 178 percent compared to the initial budget, as shown in Figure 4. Additional borrowing was primarily (66 percent) from foreign sources. Going into the crisis, Albania was already facing liquidity constraints due to maturing Eurobonds. With the added fiscal demands from COVID-19 and projected fall in revenues, the government

set about looking to maximize liquidity in the short term through borrowing; it first turned to domestic market borrowing (T-bills and bonds, in local currency and euros), and in April a concessional loan under the International Monetary Fund (IMF) Rapid Financing Instrument was disbursed. This borrowing financed the first two normative budgets. Meanwhile, preparations for a €500 million Eurobond issuance had begun prior to the onset of the pandemic, and the issuance was fast-tracked to completion in June (the process took four months, compared to the usual nine-month timeline). Moreover, the amount was increased to €650 million, responding to additional spending needs. This was used partly to pay off maturing debt and partly to provide some additional financing for the third supplementary budget. By the end of the year, the stock of debt stood at lek 1,224 billion, an increase of lek 112 billion (or 10 percent) from the end of 2019.

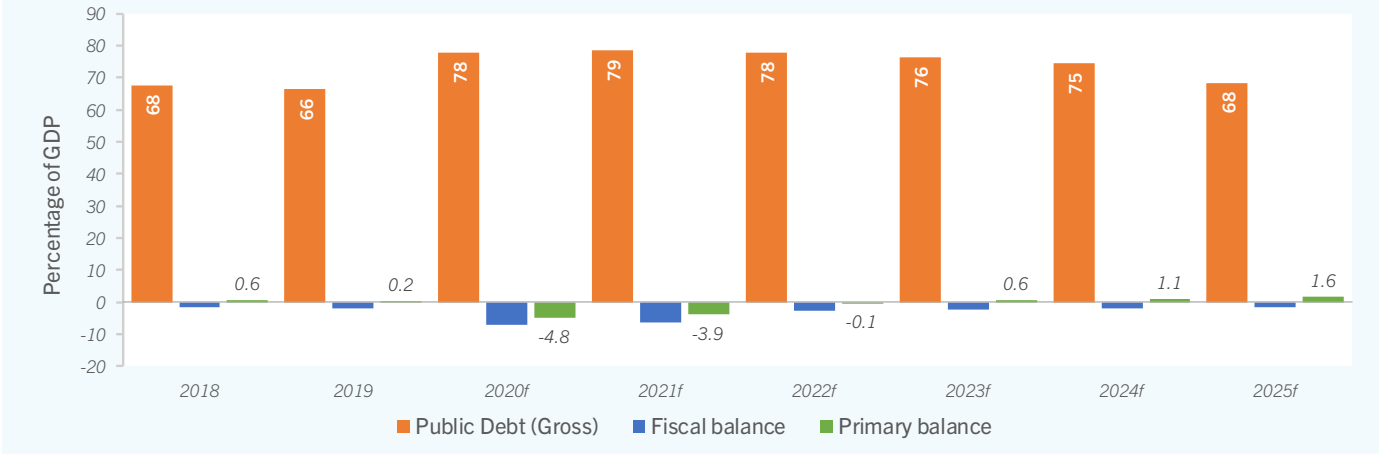
Figure 4. New financing taken on to cover the deficit in 2020



Source: World Bank based on MOFE data.

The advantages of borrowing include its possible scale and, in the COVID-19 circumstances, relative speed; however, sustainability concerns prohibit future expansion in debt at the scale seen in 2020. Albania's relatively strong capacity to borrow has proven critical for financing the country's deficit, providing large volumes of financing that have covered maturing debts, thereby avoiding the need for further budget cuts, and providing some surplus for additional spending. Borrowing is not as quick to mobilize as instruments like budget reallocation, and some external debt instruments became available only in the fourth month of the crisis. In this instance, however—with the availability of the IMF's Rapid Financing Instrument, the fortuitous circumstances in which a Eurobond was already in development, and favorable market conditions—time lags were not as large as they could have been otherwise. Long-term debt sustainability is a binding constraint. By the end of 2020, the debt-to-GDP ratio stood at 78 percent, according to GOA outturn data; of this, roughly half is domestic debt and half external. In its latest assessment, the IMF concluded that Albania's public debt is sustainable, but the debt level is high and gross financing needs are large (IMF 2020). Sustainability appears to be at the forefront of MOFE's longer-term strategy, as reflected in the latest Medium-Term Macro-fiscal Framework, which shows a clear return to fiscal consolidation and downward trajectory of debt (Figure 5). Moreover, in July 2020, an amendment was made to the OBL that specified the primary balance (fiscal deficit minus interest expenditure) cannot be lower than zero; i.e., it needs to be balanced or positive (National Assembly 2020). This signals an intended route back to more sustainable levels of borrowing.

Figure 5. Debt and primary balance forecasts to 2025

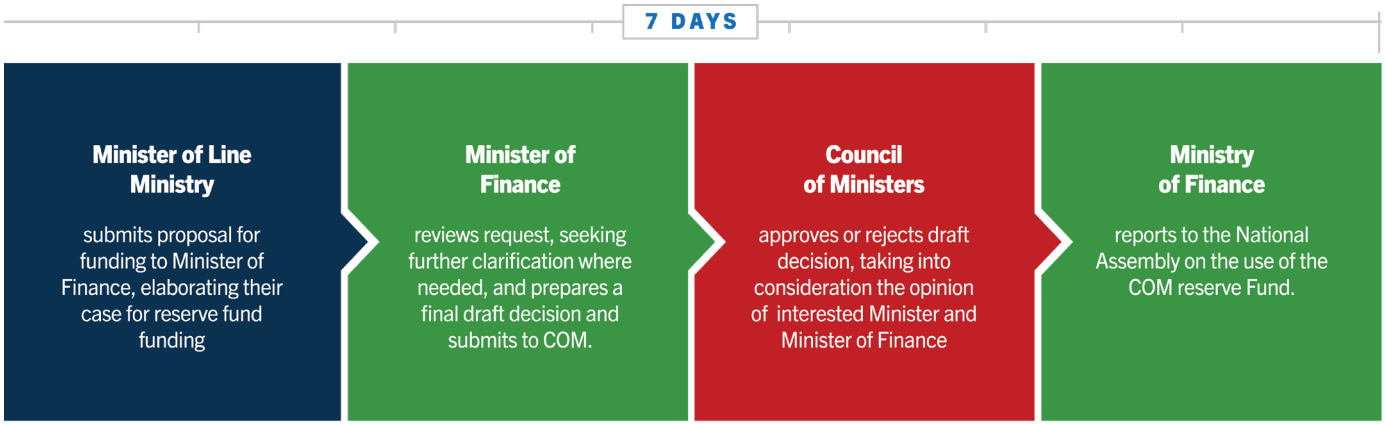


Source: World Bank based on MOFE draft Medium-Term Macro-fiscal Framework.
Note: f = forecast.

3.2.3 Council of Ministers Reserve Fund

The Reserve Fund under the Council of Ministers is an on-budget contingency account for unforeseen events, specifically for "expenses that cannot and are impossible to forecast in the course of budget implementation" (MOFE 2012); i.e., it can be used for disaster-related expenses, but not exclusively so. The process for line ministries to access financing from the COM Reserve Fund is depicted in Figure 6. On average, it takes seven days for funding requests for the COM Reserve Fund to be prepared and approved and funds disbursed. In urgent cases, such as some COVID-related requests, the process can be fast-tracked.

Figure 6. Process for accessing COM Reserve Fund



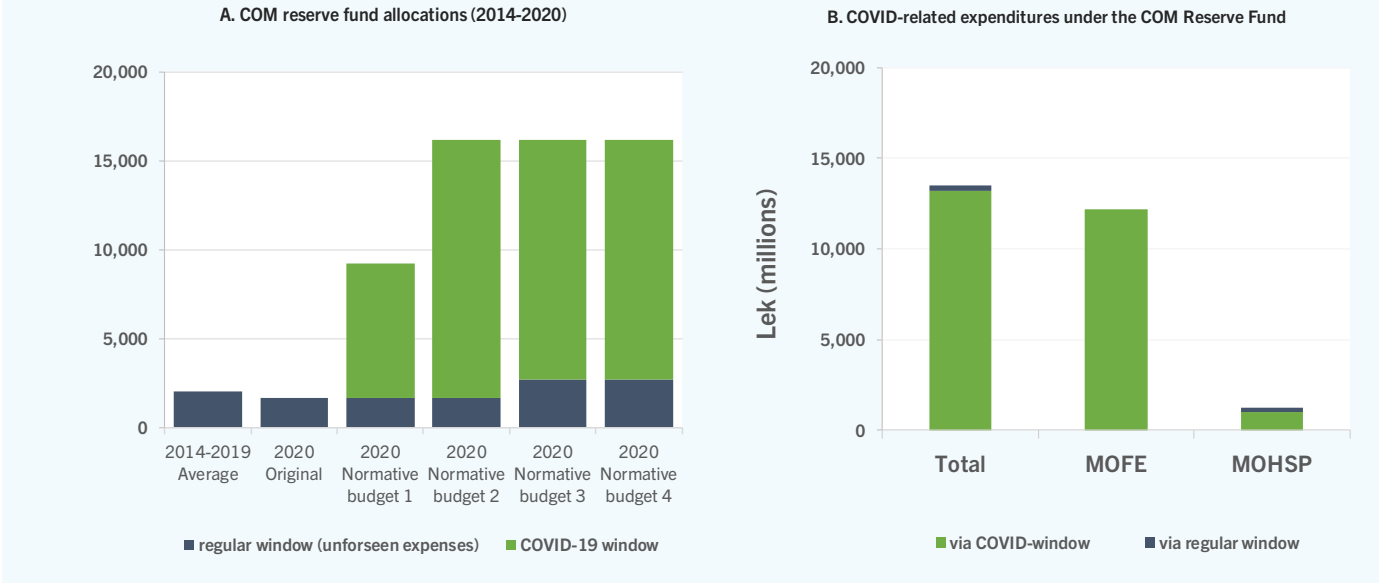
Sources: World Bank based on MOFE 2012, 2018; stakeholder interviews.

The COM Reserve Fund was used to finance significant COVID-related expenditures in 2020 through the creation of a new COVID-19 window. As depicted in Figure 7 (panel A), the budget for the COM Reserve Fund for 2020 was initially lower than in previous years. However, it was significantly augmented with the onset of COVID-19, through normative budgets 1 and 2, so much so that the final allocation to the COM Reserve Fund in 2020 (lek 16.2 billion) was more than seven times larger than the average allocation in the five years prior. A specific window for COVID-19 was created within the fund, essentially transforming a general reserve fund into a disaster fund–like instrument in a very time-efficient way.[10] In some contexts, having an emergency-specific window in a general reserve fund

10. Setting up a new disaster fund can typically take months or years, whereas the earmarking of an allocation within the reserve fund was established through the budget law, which took in its entirety less than a week to compile.

could promise advantages in terms of protecting resources from being depleted for other purposes; but in Albania the primary purpose was to give greater visibility to the government's COVID-19 response efforts. Actual expenditures for pandemic-related measures were made under the COVID-specific window and the main window of the fund, and totaled lek 13.5 billion. Most of this was spent on business employment support and unemployment benefits, managed by the MOFE (Figure 7, panel B). This COVID window was exhausted by April 16, just one day after it was recapitalized through the second normative act, largely because proposals had been scrutinized before funds were approved by the COM. Subsequent applications were rejected on account of lack of funds.

Figure 7. Allocations and disbursements under the COM Reserve Fund



Sources: BOOST data for 2014–19; 2020 budget laws (panel A); MOFE 2021b (panel B).
Note: The figure for 2014–19 is the average of the original budgets in those years (panel A); MOHSP = Ministry of Health and Social Protection (panel B).

The COM Reserve Fund was rapid to respond and accountable, but inadequate to finance substantial disaster needs. Overall, the COM Reserve Fund proved a useful COVID-19 financing instrument, particularly to finance relief and early recovery measures in the first two to three months of the crisis. It also allowed for greater accountability through higher-level scrutiny, with the COM approving all proposals. However, it did not operate like a typical reserve fund, where the resources should be allocated and protected ex ante, ready to be used as and when a need arises with clear guidelines. Instead, the fund was substantially recapitalized in the immediate onset of the crisis, something that Albania could do relatively easily because of its quick supplementary budget procedures, but additional cash had to be quickly identified for this purpose. The fact that the fund was exhausted so quickly, however, implies that on its own it was insufficient to meet the scale of the pandemic impacts. This is in line with DRF frameworks that argue that reserve funds are not the most appropriate mechanism for meeting the larger needs following low-frequency/high-impact emergencies, but that they can provide a flexible and readily available source of funds in the early stages of a crisis.

3.2.4 Summary

Table 2 provides a summary of findings in relation to question 1.

Table 2. provides a summary of findings in relation to question 1. →

Instrument	DRF categorization: Ex ante vs. ex post; risk transfer vs. risk retention [a]	Operating procedures and institutions involved	Usage in 2020	Comments on effectiveness
Budget reallocations (virements and normative budgets)	**Ex post; risk retention**	Line ministries and budget institutions prepare the basis for virements, which require no approval when they concern recurrent spending within a single program. Otherwise, reallocations on the capital budget, or between programs, require MOFE/COM approval. MOFE leads in the preparation of normative budgets, consulting with line ministries and budget institutions where time permits.	Budget reallocations (virements and normative budgets) **associated with COVID-19** in 2020 stood **at lek 17.7 billion** (see Section 3.4 on question 3).	Both virements and supplementary budgets can be very **quick** (processed in days). The restrictions around virements are such that they tend to be **limited in size**, whereas normative budgets permit more **substantive changes** to spending plans of the type needed following large-scale emergencies. Drawbacks include the **opportunity cost** associated with reallocated spending (question 4) as well as potential for **insufficient engagement with line ministries** when procedures for normative budgets are fast-tracked.
Public borrowing	**Ex post; risk retention**	MOFE, on behalf of the COM, is the only authority at central level with the right to borrow, while Parliament approves all borrowing.	There was significant borrowing in 2020 to cover maturing debt and a growing deficit. Most of this was foreign financing. Total debt stood at lek 1,224 billion, an increase **of lek 112 billion** (or 10 percent), from the end of 2019. While the study has not determined how much of this was used for COVID, a significant portion is likely to have been.	The advantages of borrowing include the **significant scale of resources** that can be mobilized, and **(in the case of Albania) comparative speed**, important due to specific circumstances in 2020. However, **debt sustainability** is a concern, and the GOA is committed to a downward trajectory of debt; this precludes the sort of jump in the debt-to-GDP ratio seen between 2019 (68 percent) and 2020 (78 percent) from happening again in the near future.
COM Reserve Fund	**Ex ante in theory, though fund was recapitalized ex post; risk retention**	Line ministries and budget institutions submit proposals, which MOFE scrutinizes before sending to COM for approval.	Outturns from the COM Reserve Fund in the amount of **lek 13.5 billion** were for **COVID-19.**	The reserve fund **disbursed funds rapidly** and gave significant oversight to accountability actors (COM). However, on its own it was **insufficient in size** for the pandemic's needs, and was quickly exhausted.

Source: World Bank.

a. Ex ante instruments are arranged in advance of a disaster occurring, although funds may still be disbursed afterwards. Ex post instruments are arranged and disbursed after the disaster. Risk retention instruments are those through which the government (and ultimately taxpayers) retain the financial responsibility for loss in the event of a shock. Risk transfer instruments are those that transfer the burden of financial loss to another party.

3.3 Question 2: What formal laws and processes govern budget reallocation decision-making? Were they followed in wake of COVID-19? What informal criteria guided decision-making?

Albania has a clear legal framework defining processes for virements, whereas the process for normative budgets is more flexible. Both were accelerated in the case of COVID-19. Criteria for determining what should be cut versus what should be augmented are not formally specified, but informal criteria were adopted by MOFE and evolved over the course of the emergency. This section discusses procedures and criteria for virements and normative budgets in turn.

3.3.1 Virements

The legal framework specifies differing criteria for virements for different expenditure classes; these criteria are strict compared to those in other countries. The OBL 2008 establishes restrictions for virements at central government level, and confirms that these can be pursued by spending units up to November 15 in any fiscal year. In practice these restrictions are comparatively stringent; line ministries are permitted to move their budget around without MOFE or COM approval only for recurrent spending within a single program (see Table 3). Other countries typically cede more powers to program managers; in the UK, for example, the rules are fairly flexible with regard to reallocation within ministries and their core agencies, and between recurrent spending items (goods and services, wages, transfers, etc.), but money cannot move between ministries or from the investment budget without parliamentary approval. In France, virements are permitted between ministries as long as the provisions are applied for the same purpose for which they were originally approved. Within a ministry, virements between programs are subject to a limit of 2 percent of the original allocation under the source program. Within a program, managers have complete freedom to move funds between subprograms and economic categories (except for personnel expenditure), including between current and capital spending. Virements from personnel expenditure to other economic categories are permitted but not vice versa. Provisions for personnel expenditure under one program can, however, be applied for personnel expenditure in another program subject to the overall limit of 2 percent (IMF 2016).

Table 3. Virement restrictions (central government)

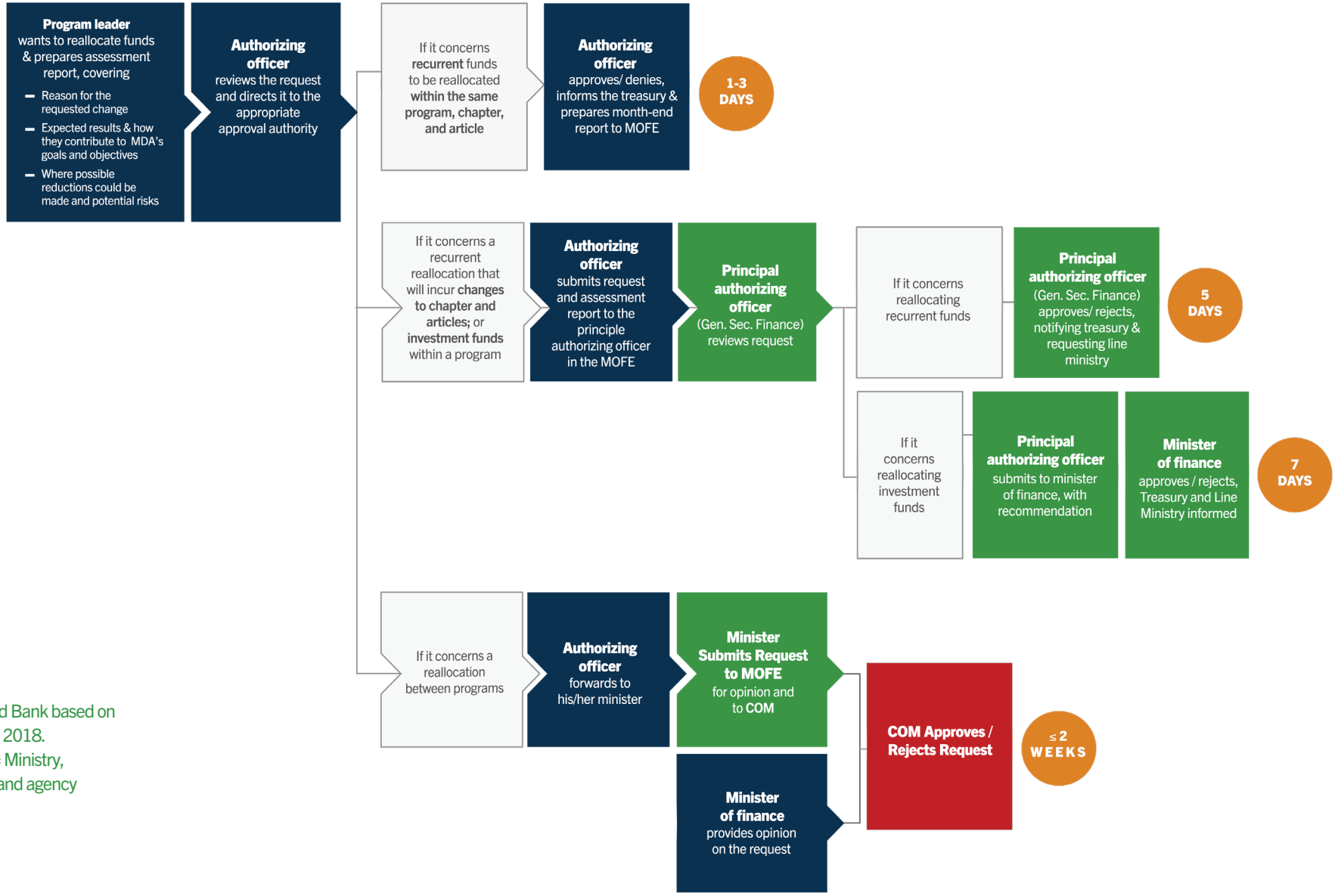
Nature of change	Limits & approval requirements	Indicative time frame	Reporting
Reallocation of funds from one program to another, within a central government unit or between various central government units— e.g., the Ministry of Internal Affairs opted to reallocate funds from the State Police (03140) to Guard of Honor services (03150)	Approval by COM; cannot exceed 10 percent of approved program recurrent/ capital budget	Can take up to two weeks to complete for funds transferred between ministries (one to two weeks for transfer within a ministry), plus two to three days for COM approval	Ex ante; authorizing officer (general secretary of the respective government unit) has to submit a Reallocation Request[a] to principal authorizing officer (secretary general of finance)
Reallocations of investment funds within the same program of a central government unit—e.g., the Ministry of Education wanted to move capital funds between two of its projects under the Basic Education program	Approval by the minister of finance	Approximately seven working days (two days in line ministry; three days with budget; two days for MOFE sign-off)	
Reallocation of recurrent funds from one chapter [b] and article [c] to another, within the same program of a central government unit—e.g., the Ministry of Education wanted to move recurrent funds from salaries to goods and services, under the Basic Education program	Approval by the principal authorizing officer (secretary general of finance)	Approximately five working days (two days in line ministry; three days with budget/secretary general of finance)	
Reallocations of recurrent funds within the same program, chapter, and article, but between various spending units in the same central government unit—e.g., the Judicial Activity program, which covers three ministries/institutions (Constitutional Court, People's Advocate. and High Council of Justice) wanted to move budget for goods and services from the Constitutional Court to the People's Advocate.	Approval by the authorizing officer (secretary general) of the Ministry Department Agency unit from which the spending unit is a subordinate body Approval by the authorizing officer (secretary general) of the Ministry Department Agency unit from which the spending unit is a subordinate body	One to three days	Ex post; authorizing officers to provide month-end report to principal authorizing officer (secretary general of finance) on reallocation decisions

Sources: World Bank based on National Assembly 2008, 2016; MOFE 2012, 2018.

a. Kërkesat për rishpërndarje in Albanian; translated as "assessment report" in earlier iterations.
b. Funding source; see Annex B.
c. Economic classification level 3; see Annex B.

The de jure processes were largely adhered to, but timelines can be condensed in cases of emergencies. The process for requesting and approving budget virements, which is established in the "Standard Procedures of Implementation of the Budget" (MOFE 2012, 2018), is summarized in Figure 8. The interviews confirmed that this process is followed in practice, and the indicative timelines are set out in the orange bubbles in the figure. In an emergency, the same steps in the process apply, but these can be compressed to proceed more rapidly. For example, review and approval within MOF would usually take three to five days but can be fast-tracked to take a single day. Such fast-tracking reportedly occurred quite frequently in the COVID-19 crisis period.

Figure 8. Process for requesting and approving virements



Source: World Bank based on MOFE 2012, 2018.
Note: MDA = Ministry, department and agency

3.3.2 Normative budgets

The process for preparing normative budgets is more condensed than that for the annual budget, usually taking up to one month. Article 160 of the Constitution gives the National Assembly the right to amend the annual budget law. Beyond specifying the need for parliamentary approval, the legal framework does not detail what the procedures for compiling a normative budget are. In practice the approach is much simpler than the process for preparing the annual budget; it includes a top-down assessment of financial resources, coupled with a bottom-up estimate of line ministry needs. In Albania, normative budgets are often prepared almost entirely within the MOFE, and typically involve much less engagement with line ministries than is the case for the annual budget.

Where a normative budget includes additional spending measures, the Budget Management Directorate will first provide an estimate of total "free funds" available from reallocations. On the capital side, this is informed by weekly progress meetings held between the Public Investment Management Directorate and line ministries implementing capital programs. Where there is no possibility of projects being fully implemented, MOFE may opt to cut certain budgets in order to free up funds. Free funds on the recurrent side are less common, but can be identified through a review of execution progress. If the full estimate of available reallocations is not sufficient to cover additional needs, the Debt Directorate then supplements this with deficit financing. Additional needs are determined by MOFE, usually with some political direction and limited consultation with a few key line ministries. The preparation process is limited to 45 days; thereafter normative budgets are subject to the same approval steps as the annual budget (i.e., they are presented to COM and the National Assembly), albeit with much less scrutiny. Unlike the annual budget, which can be changed by Parliament, a supplementary budget request can only be approved or rejected—and Parliament has not rejected any so far. Lower levels of scrutiny are justified on the basis that normative budget acts should be prepared only in an emergency or as a matter of necessity.

In the case of COVID-19, procedures for preparing normative budgets were condensed further, and the informal criteria for determining which budget lines would be cut and which augmented changed over the course of the pandemic. The first two normative budgets were prepared solely by the MOFE overnight, followed by one week of internal discussions, before going to Parliament, who approved the budget in one day (through special sittings to avoid delays). The criteria guiding decisions about what to cut were not formalized, but MOFE reported focusing first on personnel (unfilled vacancies) and then on operational expenses that were deemed no longer necessary (e.g., utility budgets for offices were safely cut in light of closures). Efforts were made to minimize cuts to investment in the first instance because it was early in the fiscal year and there was limited evidence of underspending, meaning that premature cuts could lead to arrears. However, by the second normative budget, cuts to capital were unavoidable. Identification of areas for additional financing was driven by the needs of the crisis, with extra funding going to the COM Reserve Fund, MOFE, and MOHSP.

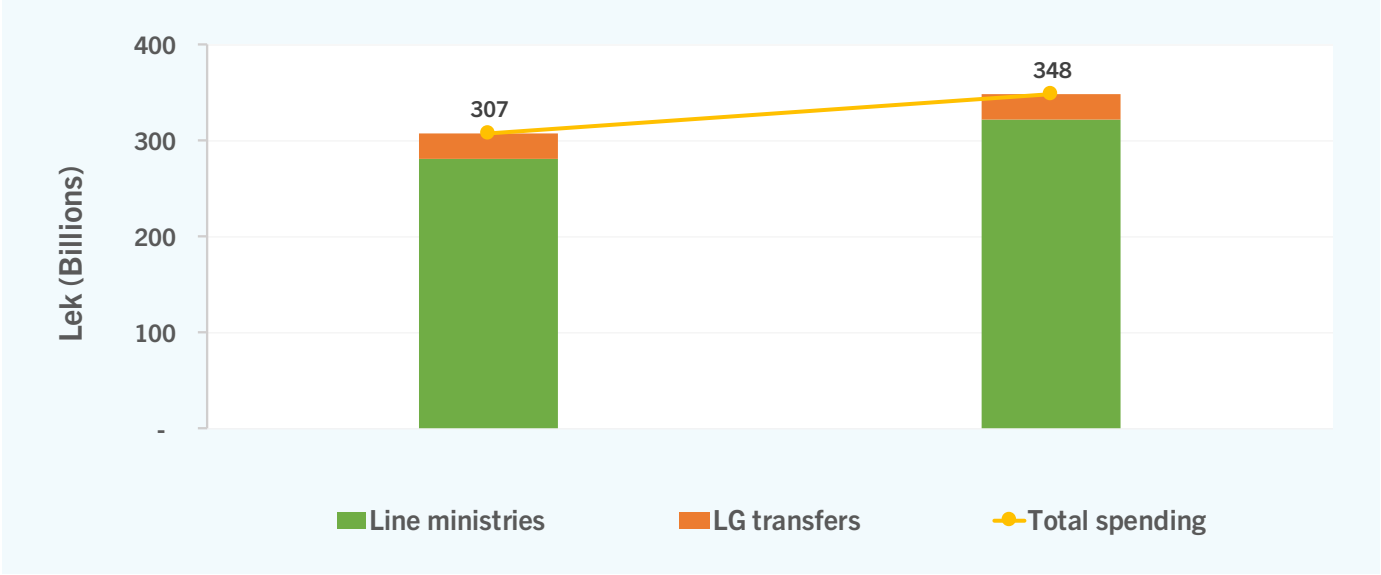
The process for the third normative act took longer, as the situation was more relaxed; MOFE took more time to analyze data on spending progress and had some limited line ministry consultations. In terms of criteria for cuts, further capital expenditures were now cut across the board based on execution performance. Extra money went to underfinanced priorities, including reconstruction, which had suffered from shortfalls in the realization of donor pledges; in addition, some of the cuts made in normative budgets 1 and 2 were reinstated. In total, the process for the third normative act took one month, which is more in line with standard practice for normative budgets. The fourth and final normative budget, falling late in the year, served less as a strategic reallocation of resources and more as a last-chance opportunity for line ministries to carry over to future years funds that would be unused. Such strategic reallocation through a last-minute normative budget is common practice in Albania, where a normative act is often passed before the end of the budget year.

3.4 Question 3: How has public expenditure deviated from existing plans on account of COVID-19?

Overall, 2020 spending by line ministries was lek 40.8 billion higher than the counterfactual, as shown in Figure 9, but this increase disguises significant areas of underspending.[11] This overspending is partially presentational, linked to the manner in which the counterfactual is constructed, and specifically the considerable number of contingencies in Albania's budget system that are unallocated to line ministries at the beginning of the year and can be tapped throughout the budget year. As it is not possible to know ex ante where these contingencies will be allocated, they cannot be included in ministry-level counterfactuals, and so in the expenditure analysis they appear as overspending for line ministries. The COM Reserve Fund (lek 16.2 billion allocation) and the Reconstruction Fund (lek 32 billion allocation) both contributed to the overspending against the counterfactual in the line ministries and municipalities that received the funds. Although at the aggregate level, overspending against the counterfactual is realized, there are a number of negative deviations, or instances of underspending, across ministries, programs, and economic spending categories, which this section examines.

11. The Government of Albania as a whole spent lek 12.9 billion, or 2.3 percent less than planned in the original budget, largely as a result of revenue shortfalls. The counterfactual takes into account historical underspending to arrive at a more modest expectation of expenditure than the budget. Thus, it is possible to overspend compared to the counterfactual and underspend compared to the original budget.

Figure 9. Counterfactual and actual spending for line ministries and local government transfers, 2020



Source: World Bank utilizing BOOST data.
Note: LG = local government.

In 2020, 57 percent of all budget programs recorded underspending compared to the counterfactual for a total of lek 17.7 billion, calculated at the ministry and program level, by economic classification. This means that on account of the pandemic, the GOA was able to extract an estimated lek 17.7 billion from planned spending of line ministries and budget institutions, and reallocate it away from its intended purpose. All overspending is excluded from these figures. To put this number into context, lek 17.7 billion is equivalent to 93 percent of total COVID-19 expenditures in 2020;[12] or 5 percent of total spending in 2020;[13] or 16 percent of additional net public debt taken on in 2020; or 131 percent of total COVID-related disbursements under the COM Reserve Fund. The rest of this section sets out where those cuts fell, but it is important to note that some reallocations will have likely had no impact and were indeed sensible; even if additional funding to the tune of lek 17.7 billion had been available, not all would have been spent on its initial intended purpose since some spending became nonviable. Section 3.5 discusses this situation when estimating the impact of budget reallocations, but this section focuses on COVID-19-related underspending in its entirety.

Although all economic classifications experienced underspending, the larger shares came from goods and services (lek 5.7 billion) and capital (lek 5.2 billion) spending. Breaking down the lek 17.7 billion by economic classifications sheds some light on the composition of underspending in 2020. As shown in Table 4, the largest amount of underspending against the counterfactual was observed in "other recurrent spending," which largely refers to goods and services.[14] This category underspent by a total of lek 5.7 billion, equivalent to 15 percent of actual expenditure on other recurrent spending. This underspending was largely the result of nonviable spending due to the economic and social restrictions introduced to fight the pandemic, rather than the result of deliberate budgetary reallocations to finance the COVID response. The second largest underspending amount appears in capital spending and totals lek 5.2 billion, or 8 percent of total expenditure on capital in 2020. Although some of this underspending was also the result of COVID-19 restrictions, a larger share was acknowledged in the interviews to be a direct result of more pressing financing needs elsewhere. No evidence of cuts to maintenance spending (for capital items) was identified within the analysis. Personnel and transfers follow with underspending of lek 4.1 billion and lek 2.6 billion, respectively. To a degree, both personnel and transfers suffered due to the COVID-19 restrictions; personnel was affected by a temporary hiring freeze due to limits on in-person meetings, before a swift move online; and transfers were affected by the suspension of the courts, followed by a slow shift online.

12. The figure is for additional expenditure plus forgone revenue and does not include below-the-line measures.
13. Total spending comprises spending by the line ministries, debt repayment, and transfers to local government. Note that this does not imply that reallocations went to finance COVID-19 expenditures. In a context of falling revenues, reallocations could also have been to protect other priority government spending, and not necessarily COVID-related.
14. Other recurrent spending includes (i) goods and services (e.g., office supplies, transportation expenses, travel expenses, maintenance, etc.), and (ii) subsidies.

Table 4. Underspending by economic classification, 2020			
	2020 underspending (thousand lek)	Share of underspending	Ratio of underspending to actual expenditure
Capital	-5,211,736	29%	8%
Personnel	-4,121,559	23%	4%
Transfers	-2,648,464	15%	2%
Other recurrent	-5,676,637	32%	15%
Other	-50,313	0%	0%
Total	-17,708,709	100%	5%

Source: World Bank utilizing BOOST data.

Note: The table includes only underspending, analyzed for each ministry by program and economic classification; it presents an aggregation of this underspending at these levels and does not present any overspending. In many cases the overspending nets out the underspending when summed at an aggregate level; however, the analysis is intended to focus only on the pockets of underspending.

The largest underspending amounts by institution arose in the Ministry of Defense, Ministry of Finance and Economy, and Ministry of Education, Sports and Youth (MOESY), together accounting for 43 percent of the underspending:

- The Ministry of Defense witnessed the largest underspending amount in 2020 at lek 3.3 billion, equivalent to 15 percent of total execution by the ministry in 2020. The interviews confirmed this was largely the result of more pressing financial needs elsewhere, with the pandemic giving the government some cover to fall below the NATO spending target for the year.
- The Ministry of Education, Sports and Youth witnessed underspending against the counterfactual of lek 2 billion, equivalent to 5 percent of total MOESY spending in 2020. The interviews suggested that some key capital projects and personnel were suspended for financial reasons, but some of the capital underspending can also be explained by the transfer of some projects instead to the Ministry of Reconstruction.
- The underspending by MOFE totaled lek 2.3 billion but equates to only 3 percent of total spending, with overall spending by MOFE much higher than planned (+38 percent) due to additional COVID-19 spending in other programs (see Box 1). Underspending mainly arose from personnel and from goods and services, with the procurement restrictions preventing much movement in these areas.

Other areas of underspending can be seen in Table 5.

Table 5. Underspending by ministry and economic classification, 2020						
	Underspending in 2020 compared to the counterfactual (thousand lek)					
	Capital	Personnel	Transfers	Other recurrent	Other	Total
Presidency	-754	-3,307	0	-59,966	0	-64,026
Assembly	0	-31,948	-249	-90,699	0	-122,895
Prime Minister	0	0	-28,207	-2,494	0	-30,701
Ministry of Agriculture and Rural Development	-384,324	-99,653	0	-503,466	0	-987,442
Ministry of Infrastructure and Energy	-119,904	-52,707	0	-406,597	0	-579,208
Ministry of Finance and Economy	-66,555	-415,370	-212,781	-1,629,042	0	-2,323,748
Ministry of Education, Sports & Youth	-821,064	-987,016	-55,006	-137,238	0	-2,000,324
Ministry of Culture	-227,427	-25,326	-57,186	-95,040	0	-404,978
Ministry of Health & Social Protection	-438,390	-31,494	-788,318	-31,154	0	-1,289,355

Table 5. Underspending by ministry and economic classification, 2020 →						
	Underspending in 2020 compared to the counterfactual (thousand lek)					
	Capital	Personnel	Transfers	Other recurrent	Other	Total
Ministry of Justice	-115,585	-91,445	-1,276,107	-170,451	0	-1,653,587
Ministry of Europe and Foreign Affairs	-5,093	-111,373	-196	-209,136	0	-325,797
Ministry of Internal Affairs	-313,395	-689,166	-2,262	-255,779	0	-1,260,602
Ministry of Defense	-1,272,525	-483,766	-39,778	-1,459,988	0	-3,256,056
State Intelligence Service	0	0	0	-126,529	0	-126,529
Radio Television Directorate	-866	0	0	0	0	-866
General Directorate of Archives	0	0	0	0	0	0
Academy of Science	0	-5,933	0	-56	0	-5,988
Supreme State Audit	-957	-8,968	0	-20,631	0	-30,556
Ministry of Tourism and Environment	-92,323	-192,161	0	-12,849	0	-297,333
General Prosecutor's Office	0	-99,334	-2,311	0	0	-101,645
High Judicial Council	-80,460	-244,408	0	-114,163	0	-439,031
Constitutional Court	-111	-26,543	-41	-12,549	0	-39,245
Albanian Telegraphic Agency	-18	0	-89	-1,873	0	-1,980
High Council of the Prosecution	-529	-27,795	0	-382	0	-28,706
Political parties	0	0	-5,256	0	0	-5,256
Special Structure against Corruption and Organized Crime	-1,525	-151,902	0	-40,627	0	-194,053
Debt Service	0	0	0	0	-50,313	-50,313
Institute of Statistics	-44,729	-181,111	-94	-98,248	0	-324,181
School of Magistrates	-2,520	0	-16,591	-10,185	0	-29,296
Albanian Development Fund	-1,196,212	0	0	0	0	-1,196,212
National Center of Cinematography	0	0	-4,174	-851	0	-5,025
Institutions of the justice system	-3,733	-33,435	0	-23,187	0	-60,354
The People's Advocate	0	0	-1,493	-782	0	-2,275
Commissioner for Civil Service Oversight	-896	-340	-31	0	0	-1,266
Central Election Commission	-17	-481	0	-4,734	0	-5,233
High Inspectorate of Declaration and Control of Assets and Conflict of Interest	-700	-340	-54	-10,359	0	-11,453
Competition Authority	-23	-5,868	-55	0	0	-5,947
National Accounting Council	0	0	0	-431	0	-431
Other government institutions	-20,072	-78,589	-7,257	-129,589	0	-235,508
Civil society support	-286	0	-40,197	-1,396	0	-41,879
Commissioner for the Right to Information and Personal Data Protection	0	0	-37	-5,790	0	-5,827

Table 5. Underspending by ministry and economic classification, 2020

	Underspending in 2020 compared to the counterfactual (thousand lek)					
	Capital	Personnel	Transfers	Other recurrent	Other	Total
Public Procurement Commission	-627	-23,978	0	-7,207	0	-31,812
Commissioner for Protection from Discrimination	0	0	0	-32	0	-32
Institute for the Study of the Crimes of Communism	0	-3,674	0	-1,968	0	-5,642
Authority for the Right to Information	-118	-14,130	0	-1,169	0	-15,417
Local government transfers	0	0	-110,695	0	0	-110,695
Total	-5,211,736	-4,121,559	-2,648,464	-5,676,637	-50,313	-17,708,709

Source: World Bank utilizing BOOST data.
Note: The table includes only underspending, analyzed for each ministry by program and economic classification; it presents an aggregation of this underspending at these levels and does not present any overspending. In many cases the overspending nets out the underspending when summed at an aggregate level; however, the analysis is intended to focus only on the pockets of underspending.

The extent of the underspending in Albania was relatively limited in 2020, largely because the government was able to access additional financing relatively quickly. The lek 17.7 billion underspending would have been significantly higher in 2020 had the GOA been unable to rapidly access additional financing. As discussed under 3.1.2, the Eurobond issuance was already in the works before the crisis, making it relatively simple to tack on additional financing needs and push it through relatively cheaply (due to favorable market conditions) and quickly (in only four months). The rapid disbursement of IMF funds also played an important role in limiting budget reallocations. If such financing options had not come online so quickly, the Government of Albania would have had to make more difficult decisions regarding how to further reconfigure the budget. When the need to reallocate is limited, it is much easier to identify areas to trim that will not have a detrimental impact. As the volumes of budget reallocations grow larger, cuts become increasingly difficult because they negatively impact development and social outcomes.

3.5 Question 4: What has been the broader impact (in terms of opportunity cost) of these budget reallocations?

As described under Section 2, impact analysis was conducted at two levels: first considering the aggregate impact of COVID-related underspending at sector level, and then developing an illustrative account of how a few specific projects have been affected. Both parts of the analysis are described below.

3.5.1 Aggregate impact at sector level

Of the lek 17.7 billion in underspending, approximately lek 7.8 billion is associated with cutting expenditures rendered nonviable by the pandemic (and thus having no associated opportunity cost). The remaining lek 9.9 billion incurs an opportunity cost when it is cut. It is this portion that forms the basis for calculations on the impact of cuts made through budget reallocations. The rules followed for these adjustments are set out in Annex B.

At the aggregate level, the estimated value forgone associated with COVID-related budget reallocations in 2020 totaled lek 12.3 billion (US$113 million). This is 25 percent higher than the monetary value of the cuts (once nonviable expenditures are excluded). The implication is that with alternative financing sources in place limiting the need for budget reallocations, lek 12.3 billion in value could have been generated from the spending spared from cuts. Table 6 sets out the details behind the calculations of value loss. It presents total underspending per sector (column 2), and specifies the portion of the underspending that was potentially value creating (column 3). The table also provides the working estimate for the marginal benefit of funds in each sector (column 6), which was adjusted from the baseline value of 1.15, based on assessments of the sufficiency of sector spending (column 4). The reasons for these adjustments are provided, drawn from the qualitative analysis (the interviews) and quantitative analysis (comparison of sector spending to GDP in comparator countries) (column 5). Finally, the table shows the estimated value forgone, which is the sum of the viable underspending in each major sector, multiplied by the estimate of the marginal benefit of public expenditure in that sector (column 7). [15]

15. Sectors follow the international Classification of the Functions of Government (COFOG) groupings.

In the grand scheme of the pandemic's economic impacts, the impact from cuts to routine expenditure has been modest. The latest forecasts from the World Bank estimate that Albania lost 8.1 percentage points of GDP in 2020 (comparing actual GDP growth [World Bank 2021a] to pre-COVID forecasts [World Bank 2020c]). Value losses from budget reallocations, meanwhile, are equivalent to a much more modest 0.77 percent of 2020 GDP. However, lek 12 billion is not negligible when compared to the estimate of the total value of COVID-19 expenditures (lek 19 billion). Moreover, the size of the impact is sensitive to the underlying assumptions used in the methodology – see Box 3 below.

Box 3. Sensitivity analysis on impact estimates

The estimate of value foregone associated with budget reallocations is sensitive to some of the underlying assumptions used, which are detailed in Annex B. This box demonstrates how altering some of the assumptions can affect the overall findings through some examples.

For example, the analysis applies weights to different economic classes of expenditure, as a means of distinguishing between expenditure which was deemed nonviable (because of the restrictions introduced in response to the pandemic), and expenditure which could have viably gone ahead had resources been readily available. The headline values for these weights were based on interviews with Government officials, however, it would be possible to argue for more and less conservative estimates of viability, affecting the final calculations of impact (with a more conservative estimate of viable expenditure being associated with a lower estimate of the impact of reallocations, and vice versa).

Similarly, assumptions were made about the marginal value of public expenditure in different sectors, based on an assessment of the sufficiency of expenditure in different sectors. For the headline estimate, it was assumed that in an optimally funded sector, the marginal benefit of public expenditure is equal to the marginal cost of funds (1.15), with adjustments made either side of this for sub-optimally or excessively funded sectors. However, with fiscal multipliers and the marginal cost of funds being highly contested concepts, it is possible to argue for more and less conservative estimates. This too affects the final calculation of impact, with more conservative estimates of the marginal value of public spending leading to a lower estimate of the impact of reallocations, and vice versa.

The table below details how these parameters have been applied in the headline estimate of impact presented in this report (lek 12.3 billion), and adjusted under two scenarios (conservative and liberal). The results suggest the impact of COVID-19 budget reallocations, in terms of value lost, could be in the range of lek 8.7 billion and lek 15.4 billion (US$80 million – US$141 million), with the lower bound being where conservative estimates of viability and the marginal benefit of funds are adopted, and the higher bound where more liberal estimates are adopted.

Employed estimates of the viability of expenditure for different economic classes, under the three scenarios:

Share of expenditure considered viable	Capital	Personnel	Transfers	Other recurrent
Headline	90%	90%	58%	25%
Conservative	80%	80%	48%	15%
Liberal	100%	100%	68%	35%

Marginal benefit of funds estimate	Very excessive sector funding3	Moderately excessive sector funding	Optimal sector funding	Moderately insufficient sector funding	Very insufficient sector funding
Headline	0.95	1.05	1.15	1.25	1.35
Conservative	0.75	0.85	0.95	1.05	1.15
Liberal	1.05	1.15	1.25	1.35	1.45

Impact of budget reallocations (lek billion)		Expenditure viability estimates		
		Headline	Conservative	Liberal
Marginal benefit of funds estimates	Headline	12.3	10.4	14.2
	Conservative	10.3	8.7	
	Liberal	13.3		15.4

Source: World Bank.

This impact would have been much greater if the additional financing had not come on board. As noted in the expenditure analysis (Section 3.4), the scale of the necessary budget reallocations in Albania was in large part mitigated by the additional financing that became available toward the middle of the year—including both the Eurobond and development finance from the EU, IMF, and World Bank. Without this, the cuts would have been deeper and the longer-term impact on the economy more severe. This is particularly so when one considers that the MOFE did a skilled job at exhausting all potential for low-cost/cost-free cuts (to spending that was no longer viable), and thus that any further cuts would entail additional value loss, becoming increasingly costly as more difficult budget cuts were made.

A breakdown of the value losses indicates that most of them fell in the general public services, defense, education, and justice sectors (together accounting for 73 percent of total estimated losses) (Figure 10). This is because the cuts to viable spending in these sectors were largest. Furthermore, the losses are augmented in the case of education (and to a lesser extent defense and justice) because they fell on an already underfunded sector. The health sector was deemed to have the most insufficient level of spending out of the 10 sectors. Compared to other sectors, it was relatively protected from the cuts, though some program-level reallocations were necessary (equivalent to 3 percent of total health spending). Very little value was lost from the cuts to the housing and public utilities sector, because much of the underspending was deemed nonviable and was discarded from the impact analysis.

Figure 10. Distribution of impact across sectors

Source: World Bank.
Note: Percentages above the blue bars refer to sector losses as a share of total losses.

Table 6. Breakdown of impact analysis calculations →

Sector	Total underspending vs. counterfactual 2020 (lek, millions)	Total underspending excluding nonviable expenditures (lek, millions)	Summary assessment of optimality of expenditure	Explanatory remarks	Sectoral marginal benefit of funds	Estimated value loss of underspending (lek, millions)
01. General public services	-4,386.79	-2,281.17	Optimal	Both sets of interviews—with government and nongovernmental organizations (NGOs)/semi-autonomous agencies—considered spending in this sector to be **optimal**, despite the cuts. As a share of Albania's GDP, sector expenditure was **comparable** to other comparator countries (5 percent of GDP versus 4.2 percent, which is 120 percent in relative terms).	1.15	-2,623.34
02. Defense	-3,029.45	-1,824.71	Moderately insufficient	Government interviewees suggested defense spending was **moderately** insufficient (pointing to slowed progress toward NATO targets); however, NGOs and the central bank considered it **optimal** (with some pointing to the arbitrary nature of NATO targets). Regarding the quantitative analysis, Albania's spending on defense as a percentage of GDP was **very insufficient** when compared to comparator countries (only 48 percent of the comparator average—0.8 percent versus 1.7 percent).	1.25	-2,280.89
03. Public order, security, and judicial work	-2,186.90	-1,598.86	Moderately insufficient	Government interviewees considered spending in this sector to be **optimal**, even in light of cuts. Views from NGOs/semi-autonomous agencies varied, from **optimal** to **very insufficient**; interviewees noted the ongoing judicial reform agenda in the country, against which cuts were deemed highly problematic. As a share of GDP, sector spending in Albania looked **moderately insufficient** compared to comparator countries, at 1.84 percent of GDP versus 2.5 percent, which is 72 percent in relative terms.	1.22	-1,945.28
04. Economic relations[a]	-1,809.31	-1,014.49	Moderately insufficient	Government interviewees suggested expenditure was **moderately insufficient** (in particular in relation to construction needs). Views from NGO/semi-autonomous agency interviews varied, from moderately insufficient (noting that garment manufacturing suffered, although it was able to shift to PPE production fairly quickly), to **moderately excessive** (arguing that the private sector should be more self-sufficient). As a share of GDP, sector spending in Albania looked **very insufficient** compared to comparator countries, at 2.8 percent of GDP versus 6.4 percent, which is 44 percent in relative terms.	1.25	-1,268.11

Table 6. Breakdown of impact analysis calculations →

Sector	Total underspending vs. counterfactual 2020 (lek, millions)	Total underspending excluding nonviable expenditures (lek, millions)	Summary assessment of optimality of expenditure	Explanatory remarks	Sectoral marginal benefit of funds	Estimated value loss of underspending (lek, millions)
05. Environmental protection	-204.17	-167.59	Very insufficient	Government interviewees considered spending in this sector to be **optimal**, and shortfalls in financing were accommodated. Other interviewees considered it to be **moderately or very insufficient,** pointing to historically low budget shares as well as growing public awareness of the importance of environmental protection in light of trends such as climate change. As a share of GDP, sector spending in Albania looked **very insufficient** compared to comparator countries, at 0.19 percent of GDP versus 0.53 percent, which is 36 percent in relative terms.	1.28	-215.08
06. House-building and public utilities	-1,204.82	-5.89	Optimal	All interviews considered spending on house-building and public utilities to be **optimal**, as a historical priority cemented with the post-earthquake boost. Some commented that high levels of spending were appropriate now, but possibly not over the long term. As a share of GDP, sector spending in Albania looked **moderately excessive** compared to comparator countries, at 2.18 percent of GDP compared to 1.67 percent, which is 131 percent in relative terms. This is understandable as the quantitative analysis does not capture varying needs, like those arising from the earthquake.	1.12	-6.57
07. Healthcare	-1,247.09	-858.99	Very insufficient	Both sets of interviews (government and NGO/semi-autonomous agencies) considered spending in this sector to be **very insufficient**, with the pandemic exposing historical underfunding of the health sector. Regarding the quantitative analysis, as a share of GDP sector spending in Albania looked **moderately insufficient** compared to comparator countries, at 3.05 percent of GDP versus 4.21 percent, which is 72 percent in relative terms.	1.32	-1,131.01
08. Recreation, culture, and religion	-471.94	-320.64	Moderately insufficient	Interview responses about the sufficiency of spending in this sector ranged from **optimal** to **moderately insufficient.** As a share of GDP, sector spending in Albania looked **very insufficient** compared to comparator countries, at 0.44 percent of GDP compared to 1.13 percent, which is 39 percent in relative terms.	1.25	-400.80

Table 6. Breakdown of impact analysis calculations →

Sector	Total underspending vs. counterfactual 2020 (lek, millions)	Total underspending excluding nonviable expenditures (lek, millions)	Summary assessment of optimality of expenditure	Explanatory remarks	Sectoral marginal benefit of funds	Estimated value loss of underspending (lek, millions)
09. Education	-2,618.07	-1,668.52	Moderately insufficient	Government interviewees considered spending in education to be **moderately insufficient,** pointing to some reconstruction spending that had to be postponed and arguing that budget increases given over the course of the year were long overdue. Other interviewees considered it to be **moderately or very insufficient,** arguing that as with health spending, the pandemic brought to light the consequences of historical underspending. As a share of GDP, sector spending in Albania looked **moderately insufficient** compared to comparator countries, at 3.32 percent of GDP compared to 4.45 percent, which is 74 percent in relative terms.	1.28	-2,141.26
10. Social security	-550.18	-209.36	Moderately insufficient	Views of NGO/semi-autonomous agency interviewees varied, from very insufficient (with arguments that the COVID-19 relief provided was insufficient, particularly in light of high levels of informality in the labor market and an aging population), to **moderately excessive** (arguing that the issue was instead about inefficiencies related to the "pay as you go" pension scheme). Regarding the quantitative analysis, as a share of GDP, sector spending in Albania looked **optimal** compared to comparator countries, at 9.47 percent of GDP compared to 11.40 percent, which is 84 percent in relative terms.	1.20	-251.23
Total	-17,708.71	-9,950.22				-12,263.58

Source: World Bank.
Note: PPE = personal protective equipment.
a. This sector includes the following: 041 General economic, commercial, and labor affairs; 042 Agriculture, forestry, fishing, and hunting; 043 Fuel and energy; 044 Mining, manufacturing, and construction; 045 Transport; 047 Other industries; 048 R&D economic affairs; 049 Economic affairs (unclassified).

3.5.2 Illustrative project-level impacts

In addition to the sector analysis, this section presents examples of how some government projects were impacted. These are intended to be illustrative, and cannot be used to infer any findings for the impact of reallocations overall. Nonetheless, they serve to demonstrate the different channels by which budget reallocations can undermine the achievement of project objectives, and suggest the potential knock-on implications for project performance, contingent donor financing, and the realization of sector plans.

In the education sector, the Ministry of Education, Sports and Youth reported that two university reconstruction projects were postponed because the allotted resources were cut from the ministry's budget and reassigned to COVID-related needs. Every year, higher education institutions are invited to apply for additional funding by submitting proposals to MOESY. A limited number of projects are approved each year, and funds to support them are transferred from the MOESY budget. In 2020, MOESY selected two projects, both related to reconstruction of institutions damaged in the November 2019 earthquake: (i) the Faculty of Civil Engineering and Architecture, Polytechnic University of Tirana, and (ii) the Faculty of Biotechnology and Food, Agricultural University Tirana. Following COVID-related budget cuts, however, MOESY delayed the financing of these projects until 2021. This COVID-19-related delay is estimated to have resulted in a lek 1.5 billion loss to the Albanian economy (in net present value terms) over a period of 15 years, equivalent to benefits of nearly three times the total cost incurred by the government in reconstructing the faculty buildings. Although drawn from only one illustrative example, these estimates demonstrate that project-level cuts during disasters are by no means insignificant. An analysis of the impact of these changes is presented in Box 4 and elaborated in more detail in Annex C.

Box 4. The impact of cutting reconstruction spending for two universities

The delay in reconstructing two faculty buildings due to COVID-19-related budget cuts led to quantified economic losses estimated at nearly three times the total cost incurred by the government in reconstructing the buildings. The summary results of the cost-benefit analysis (CBA) are presented in the table below, **with the main losses originating from the loss of graduate earnings.**

Element of CBA calculation	Albanian lek	US dollar
Total investment cost (undiscounted)	656 million	6.34 million
Total reduced Investment cost due to delay (discounted)	28 million	0.27 million
Total loss due to delayed investment (undiscounted)	1,708 million	16.50 million
Total loss (discounted)	1,511 million	14.60 million
Total net present value of loss (discounted change in total investment cost less total discounted loss)	**1,482 million**	**14.31 million**

Source: World Bank analysis.

The impact of COVID-19 delayed the issuing of the faculty reconstruction contracts by one year (from 2020 to 2021). COVID-related delays in executing contracts have also resulted in lower spending in the first year under the contracts, meaning that funds have been disbursed in 2021 more slowly than originally planned in 2020. Over the 15-year time frame assumed for the analysis, COVID-19 has led to benefits from the reconstruction being registered over only 12 years, rather than the originally planned 13 years had COVID-19 not occurred.

The main source of economic loss is the loss of graduate earnings, which arises because students are unable to utilize faculty premises and complete their studies. In addition, two indirect impacts have been quantified: (i) the loss of private sector profits as a result of lower consumer spending out of earnings; and (ii) reduced government revenues from income taxes. The direct earnings loss is estimated to account for two-thirds of the total quantified economic losses, while the indirect losses are estimated to represent around a third of the total economic losses.

The estimation of the losses incurred is conservative. First, the loss of graduate incomes is quantified over only 15 years, rather than a full working lifetime of 30–40 years; second, the full range of likely indirect losses is not included; and third, broader social and societal impacts have not been included due to conceptual and methodological difficulties in estimating such costs. These factors mean that the true impact of COVID-19 as a result of the delay in MOESY capital spending in Albania is likely to exceed the estimate in this CBA.

Moreover, cuts to some projects have had knock-on implications for donor funding; this was the case where the defunded activities related to donor financing conditionalities, as in the Social Assistance Modernization project. Financed with World Bank loans totaling US$60 million in addition to government counterpart funding, this project concerns reforms to Albania's social assistance programs, in particular disability assistance and poverty-targeted transfers. Before the pandemic hit, the project was on track to meet all of the disbursement-linked indicators (DLIs) necessary for triggering disbursement of World Bank financing; but in 2020 the pandemic caused significant disruption, both through the physical and social constraints caused by lockdowns and through government budget reallocations that diverted public funds away from DLI-related activities. For example, one DLI is related to the functionality of the disability allowance management information system and the scrutiny of new applications. Because of budget constraints, some of the technical experts due to be hired by MOHSP to conduct the assessments in 2020 were not recruited, though the ministry expects to pick up this process in July 2021. A second DLI concerns the investigation of cases of suspected fraud. Although the technical specification for an inspections module in the management information system was completed, the government was not able to allocate the budgetary resources for software development, thereby compromising the DLI. The World Bank issued an 18-month extension for the project to account for the delays caused to the disbursement schedule (World Bank 2021b).

In some sectors, including defense, the disruption caused by budget reallocations undermined progress in strategic plans. The expenditure analysis demonstrated that the Ministry of Defense suffered significant underspending in its combat forces programs. Objectives for these programs center around improving the operational capacities of ground, sea, and air forces. However, some of the canceled spending undermined these objectives, including cuts related to the purchase of weapons, ammunition, equipment, and machinery for the armed forces, as well as underspending against recruitment (because specialized recruitment processes weren't viable under the COVID-related contact restrictions). A review of the ministry's annual monitoring report demonstrates that these cuts fed through to underperformance against key performance indicators, which are defined and monitored for all ministries in the Albanian Financial Management Information System. For example, the modernization of naval forces project was canceled completely, resulting in the failure to meet all associated outputs. The modernization of the air force project included the planned purchase of an integrated airspace surveillance system, as well as specialized equipment and hangars for combat aviation helicopters—but none of these materialized.

Conclusions and options for consideration 4

The use of budget reallocations in Albania in the wake of the 2020 COVID-19 crisis was significant. In total, reallocations freed up lek 17.7 billion (compared to the counterfactual). Compared against the total amount of money that the government spent to fight the crisis—lek 19 billion—this is significant, equivalent to 93 percent of total COVID-19 expenditures in 2020, or 5 percent of total government spending in 2020.

Extensive borrowing in 2020, however, meant reallocations were not as large as they would have been otherwise. Total debt stood at lek 1,224 billion, an increase of lek 112 billion (or 10 percent), from the end of 2019. As a share of GDP, debt grew from 67.9 percent in 2019 to 77.9 percent in 2020. Additional borrowing was critical for making up for revenue shortfalls. Had this borrowing not taken place, more extensive and costly budget cuts would have been necessary in 2020. In some regards, the crisis was well timed in relation to borrowing, as a Eurobond issuance was already in the works and could be fast-tracked and augmented to provide critical financing needed that year. This may not be the case for future emergencies, particularly in light of growing debt levels, the government's committed path to fiscal sustainability, and potentially less favorable markets.

As an instrument for financing disaster response, ex post budget reallocations offer some significant advantages. First, they are quick in Albania, particularly in the case of normative budget acts, which can be prepared in a very short time frame (a matter of days). They are also subject to some scrutiny from the Council of Ministers, although this is less extensive than it is for the annual budget and involves less participation from line ministries. Indeed, budget reallocations in Albania entail a tradeoff between speed and broader participation and scrutiny, which can be damaging for budget credibility (particularly when normative budgets are drawn upon frequently outside of crisis years).

As the analysis has demonstrated, reallocations are not always free, and above a certain level they impose a significant opportunity cost. Of the lek 17.7 billion underspent, approximately lek 7.8 billion had no associated opportunity cost because the pandemic had rendered the activities planned for financing nonviable. However, the remaining lek 9.9 billion of cuts were not free but incurred an opportunity cost. In total, the impact of these lek 9.9 billion in reallocations is estimated at lek 12.3 billion, 24 percent higher than the monetary value of the cuts themselves. With alternative financing sources in place limiting the need for budget reallocations, it seems that lek 12.3 billion in value could have been generated from the spending spared from cuts. This is equivalent to 0.77 percent of GDP, whereas more direct impacts of COVID-19 on the economy were estimated at 8.1 percent of GDP. The implication, at least in this case study, is that the impact of budget reallocations is a lesser, but still significant, channel through which disaster impacts are felt on the economy. An illustrate analysis of how specific government projects were impacted too demonstrated that budget reallocations incur an opportunity cost; the delay in reconstructing two faculty buildings led to quantified economic losses estimated at nearly three times the total cost of the reconstruction.

The more a government relies on budget reallocations, the more costly they are. The GOA was very astute in opting to cut nonviable (i.e., zero-cost) expenditures first. This practice should be replicated in other countries. There is, however, a natural limit to such "free" cuts; moreover, it is likely that for other types of disasters or external shocks, which do not restrict economic activity so widely, the amount of the nonviable expenditures would be much smaller. After these initial cuts, subsequent cuts incur an economic cost that increases at a growing rate with the volume of cuts necessitated. Having exhausted all nonviable expenditure cuts, it is advisable to next turn to areas of projected underspending (based on execution performance against past trends). After that, it makes sense to cut lower-priority spending, taking into consideration development priorities, projected returns of individual projects, and the underlying sufficiency of spending in different sectors. To a degree, MOFE did adopt some of these criteria, for example when reviewing execution performance ahead of capital expenditure cuts in the third normative act. But these criteria should be formalized and agreed with line ministries ex ante to render the decision-making process more transparent and quicker, and provide line ministries with more predictability in relation to in-year budget changes.

To improve budget credibility in the face of future disasters or shocks, the GOA should consider two key measures that would lessen its reliance on budget reallocations and other ex post sources of financing, while also making budget reallocations more cost-efficient:

1. **Adopt a framework for approaching disaster-related budget reallocations.** Although budget reallocations are fast in Albania, this benefit needs to be carefully balanced against the lack of engagement from line ministers and subsequent risk to budget credibility during (and beyond) crises, as well as the opportunity cost of reallocating the budget. The government should consider developing a framework for budget reallocations that includes shifting them from a rushed ex post instrument to a pre-planned ex ante instrument by pursuing some of the options set out in the framework for approaching disaster-related budget reallocations (more details are in Chapter 5). Implementing such a framework would facilitate greater engagement with line ministries, greater scrutiny from Parliament, and a more credible budget.

2. **Develop a more comprehensive approach to financing post-disaster needs.** A proactive approach to budget reallocations should be couched within a broader disaster risk financing strategy to ensure that the costs and benefits of such an approach are weighed against other available financing tools, such as risk transfer instruments and a cost-effective use of domestic public finance (see Box 5 on how to prepare a DRF strategy). The experience of COVID-19, however, has emphasized the blind spot in Albania's approach to financing disasters in terms of availability of ex ante instruments, and in particular risk transfer mechanisms. At present, the GOA has a number of approved instruments that are yet to be established and operationalized; and nearly all of the risk remains on the GOA's balance sheet. Barring some negligible grant-form ODA, Albania has essentially no access to risk transfer tools. This leaves Albania's public finances vulnerable to shocks. A more strategic approach to disaster risk financing could help to identify the most cost-effective and timely way to mitigate this vulnerability. Potential measures could include the following:
    - Augmenting the COM Reserve Fund (potentially making the COVID-19 window a permanent disaster window that is ex ante capitalized and protected with clear guidelines). A DRF strategy would facilitate discussions around the optimal size of such a reserve fund.
    - Bringing into operation some of the dormant DRF instruments, such as the planned Solidarity Fund, or line ministry–level disaster contingencies. A DRF strategy would enable a cost-benefit approach to optimizing instrument choice.
    - Exploring risk transfer options and increasing penetration of insurance for households and farmers to reduce the burden on the government's budget.
    - Investing in mechanisms to strengthen channeling of post-disaster financing, such as improving procurement systems to handle emergency spending.

Disaster risk finance strategies help governments decide on how to finance contingent liabilities in a more cost-effective and timely way through prioritizing post-disaster needs and deciding on an optimal risk-layering approach.

Box 5. How and why to prepare a disaster risk financing strategy

After a disaster, such as the recent pandemic or an earthquake or flood, governments are usually liable for some post-disaster expenditures. This liability (whether implicit or explicit) can be substantial, involving government coverage of emergency response, rehabilitation of public assets, fiscal transfers to local governments, welfare support, and (sometimes) reconstruction of private houses and support to businesses. These costs from disasters (including more recently the COVID-19 pandemic) are contingent liabilities for the government and are financed through various means. For example, to respond to the COVID-19 pandemic, the Government of Albania has heavily relied on ex post budget reallocations and borrowing.

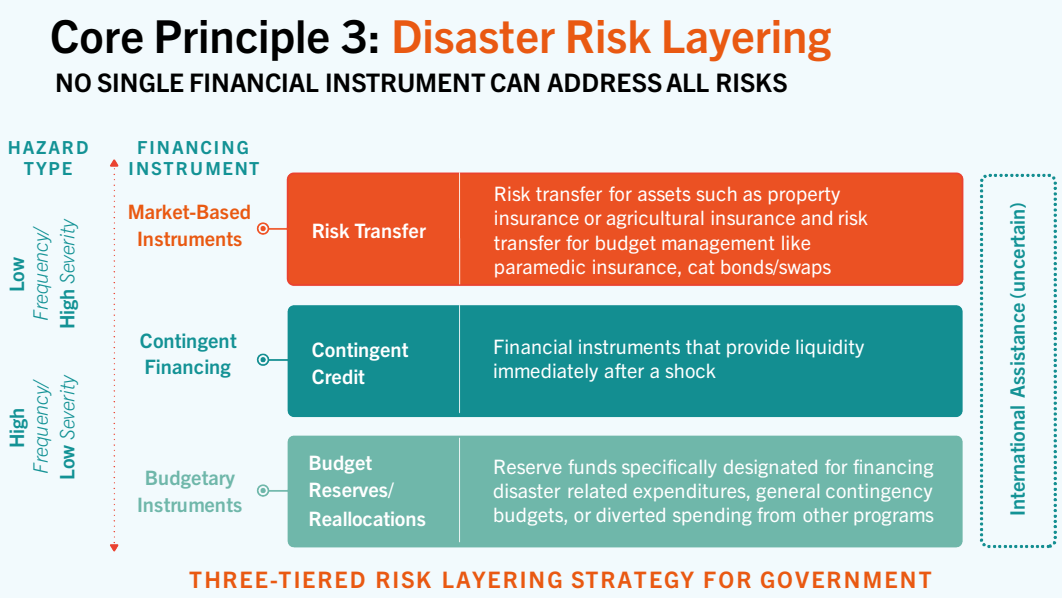
Developing a comprehensive disaster risk finance approach is more important than ever due to the economic impact of the COVID-19 pandemic, which led to tremendous fiscal strain. The pandemic led to deteriorating fiscal balances, and it increased debt to borderline unsustainable levels; moving forward, Albania is transitioning toward a path of fiscal consolidation in which embedding risk financing into fiscal policy is critically important. The Ministry of Finance and Economy needs to protect the budget from exogenous shocks as it engages in this process. Disaster risk finance can increase transparency, improve efficiency, and leverage the private sector—all of which both reduce the cost of response to the budget and increase the credibility of and trust in public expenditure.

Disaster risk finance helps governments finance their contingent liabilities in a more cost-effective and timely way by helping them prioritize post-disaster needs and decide on an optimal risk-layering approach. A comprehensive DRF approach includes agreeing in advance on how to fund post-disaster costs should they arise (Ghesquiere and Mahul 2010)—for example, by combining reserve funds, contingent credit, and insurance (Figure 11), and by developing rules on disbursing funds and monitoring expenditure. This approach allows the government to save money compared to relying on ex post instruments such as budgetary reallocations. The World Bank DRF diagnostic for Albania (World Bank 2020a) provides an overview of the status of the country's financial preparedness to disasters, including an overview of the different risk financing instruments available.

When developing a disaster risk finance approach, there are many factors that need to be considered alongside the objectives and priorities of the government. These factors include (i) expenditures (i.e. on insurance premium), debt (e.g. cost of credit) and opportunity cost of different instruments, (ii) the possible reduction of the funding gap

for losses of different sizes, (iii) the timing of when these sources of financing might be needed, (iv) the effectiveness of delivering financing through these instruments, (v) the types of costs that can be covered through different instruments, and (vi) reduction of the chance to exhaust any single source of funding. Priorities of the government could include reducing budget volatility, protecting lives and livelihoods, and aligning responsibility between national and local government for financing post-disaster costs, among others.

Figure 11. Three-tiered risk-layering strategy for governments



Source: World Bank and GFDRR 2014.

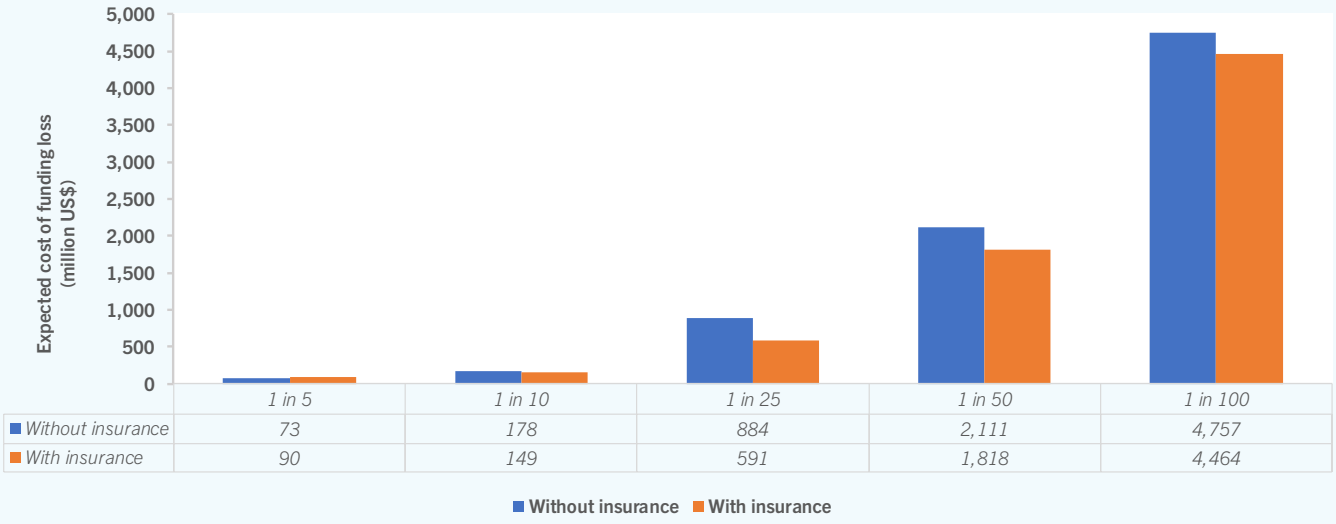
The World Bank has developed a theoretical framework to better understand how instruments can form the most effective risk-layering strategy (Clarke et al. 2016). This framework makes it possible to compare the relative opportunity cost of funding disaster losses of a specific size, using strategies with different combinations of risk financing instruments. For example, this framework can utilize (i) the opportunity cost of budget reallocations as demonstrated in this report (the cost for the initial layer of budget reallocations is negligible, but it materializes following a certain threshold of cutsa); (ii) the cost of reserve funds, which originates from not using these funds to finance other development and recurrent needs but depends on the estimated frequency of disasters and how often such funds are expected to be used; and (iii) the cost of other instruments such as insurance, which is determined by the cost of premiumsb and depends on the estimated frequency of payout.

Albania's disaster risk profile (developed by AIR Worldwide specifically for earthquakes and floods; see World Bank [2020a]) allows to apply the above framework to compare efficacy of combining insurancec with a reserve fund and some level of budget cuts: putting in a place a more diversified set of risk financing instruments could save the government up to 16 percent for events that have a 10 percent chance of happening every year (using the World Bank framework, the disaster cost would be US$149 million—rather than US$178 million—because of the insurance payout). The opportunity cost of insurance will depend on the estimated frequency of the payout; while on average one would expect to pay more in premiums than one received in payouts, insurance can be cost-effective for higher-severity, lower-frequency events.

Figure 12 below compares the costs of different sets of disaster risk finance instruments, one with and one without

insurance. The use of insurance in addition to the reserve fund and limited budget reallocations is explored for simplicity and is not a recommended strategy. If the government were to utilize a more optimized combination of DRF instruments, further savings could arise, and there would be greater payout certainty in the event of a disaster. Optimization could include carefully planning for a sustainable amount in budget reallocations, but also activating dormant sources of finance such as Albania's Solidarity Fund and combining them with a contingency credit line and sovereign risk transfer (such as insurance or capital market instruments). In addition, increasing penetration of different risk transfer instruments such as household insurance could reduce the government's contingent liabilities.

Figure 12. Comparison of costs of DRF strategies with and without insurance for events with different return periods



	1 in 5	1 in 10	1 in 25	1 in 50	1 in 100
Without insurance	73	178	884	2,111	4,757
With insurance	90	149	591	1,818	4,464

Source: World Bank based on AIR Worldwide data.
Note: The DRF strategies were developed to address earthquakes and floods.

Shifting from a reliance on ex post financing toward a combination of different sources of pre-arranged funds is likely to reduce costs (possibly quite substantially), especially if debt is high. It is important to be able to address costs for both small frequent shocks and big rare ones—and to do so, an appropriate financing structure is necessary. For both types of events, pre-positioned finance will allow a more cost-effective and timely approach to disasters. The World Bank theoretical framework for comparing costs of different instruments can be refined by the government to include other sources of funding and used as a basis to plan for a comprehensive disaster risk finance approach. This work can align with the development of a DRF program by the Ministry of Finance and Economy of Albania.

a. It is possible to assume that the social rate of return on projects not funded due to budget reallocation is 0 percent for the first lek 7.8 billion (≈US$72 million), and that any budget cuts above this amount have an opportunity cost of 24 percent.

b. As an initial assumption, it is possible to consider the pricing multiple to be 1.5, which means that for every US$1 of expected payout, the insured is charged US$1.5. This is the pricing multiple used for the DRF diagnostic work. It is not based on a review of possible earthquake and flood policies; but for a catastrophic insurance policy with tail risk and high levels of volatility, this assumption is not out of line with pricing multiples assumed in the insurance market.

c. A hypothetical insurance instrument has been modeled to broadly cover 40 percent of losses that occur on average once every 5 to 20 years. The assumption that 40 percent of payouts will be covered by insurance is made to allow for a more realistic payout, as it is unlikely that insurance will be purchased to cover every loss. For example, insurance may have been purchased only for public assets and not commercial buildings.

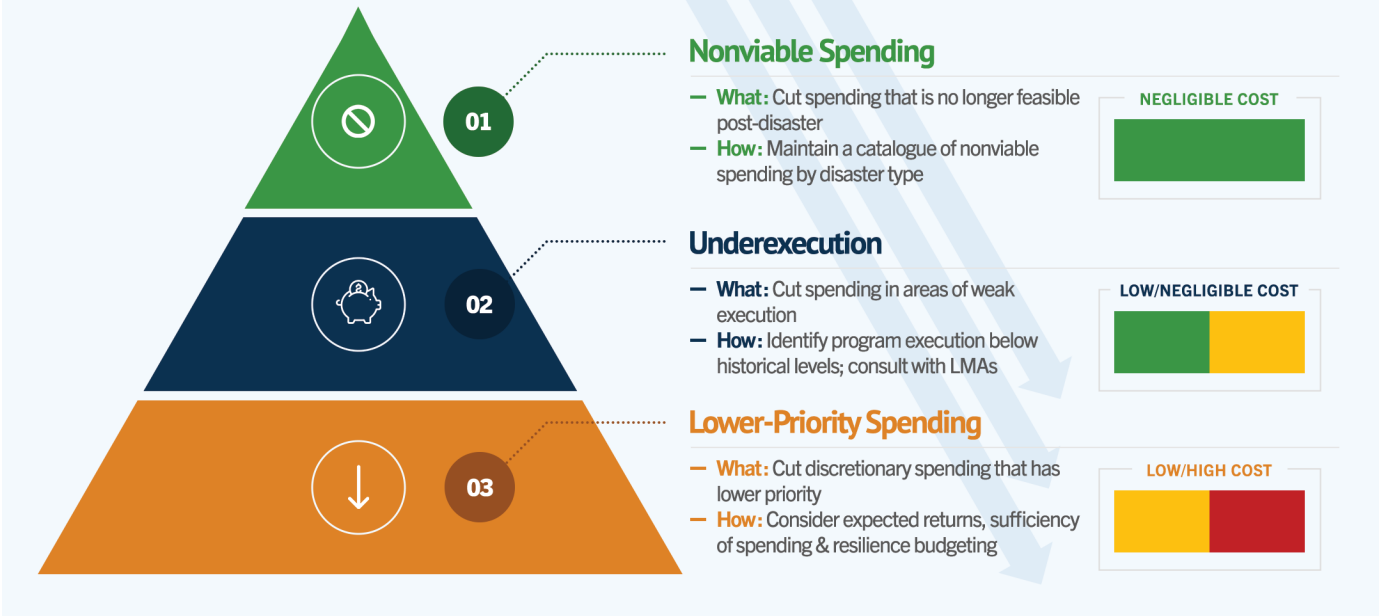
Recommended framework for approaching disaster-related budget reallocations 5

Considered as a disaster event, the global COVID-19 pandemic is by its nature relatively unique. However, some lessons can and should be drawn from experiences with the pandemic across the globe and applied in the context of natural disasters and broader external shocks. While the huge cost of COVID-19 has led to ample research focusing on a range of financing instruments utilized during the pandemic, there remains a relatively limited understanding of how to best use budget reallocations—government's quickest source of financing, in most cases—in the event of a pandemic or other crisis. Best practice in disaster risk financing suggests that pre-arranged financing facilitates rapid response, increases cost-effectiveness, and facilitates decision-making. However, it is not always possible to have all the funding arranged ex ante.

Budget reallocation (including virements and supplementary budgets) is an ex post financing instrument that offers quick cash to governments at the early stages of an external shock, acting as a useful stopgap before additional financing becomes available. There is, however, a cost to this type of instrument, as set out above. But such costs can be minimized if budget reallocations are viewed more as an ex ante financing tool, and are not considered solely as an ex post instrument.

This chapter proposes a framework for approaching disaster-related budget reallocations that helps avoid any recourse to indiscriminate across-budget expenditure cuts and instead minimizes the unintended negative consequences from delayed or canceled expenditures. The framework is illustrated in figure 11, and described in more detail below. In principle, implementation of this framework should be done jointly between the Ministry of Finance and line ministries, with the former setting guidelines and having final say on which spending lines should be considered for reallocation under each tier of the framework, and line ministries making proposals (for what should be cut or protected), in line with the guidelines, and based on their technical expertise and implementation understanding. To ensure the greatest returns, this proactive reallocation strategy should be couched within a broader DRF strategy.

Figure 13. Framework for approaching disaster-related budget reallocations



Source: World Bank.; Note: LMAs = line ministries and agencies.

1. Nonviable spending

Cost potential:

Nonviable spending can be defined as spending that is no longer feasible or effective once a disaster or external shock has occurred. The cost of canceling such expenditures is zero to negligible because even if additional financing was available, the government would not move forward with these expenditures since they would not generate returns. During the pandemic, there were ample examples of

such spending activities. In-person training of public officials became nonviable due to restrictions limiting the number of people able to gather. International travel bans meant expenditure on tourism advertising campaigns was ineffective and hence nonviable. While not all disasters or external shocks will render such a large proportion of government spending nonviable, there will be pockets of such spending, and these should be prioritized for budget reallocations since no price tag is attached to them.

Identifying nonviable expenditure

When a disaster or external shock strikes, it is important to identify nonviable spending as soon as feasible so as to protect other areas of spending from damaging cuts. This effort should be carried out chiefly by delegating responsibility to the lead government agency. In the pandemic, it was the Ministry of Health and Social Protection, along with some others, that was responsible for setting out what restrictions were in place, and from these the Ministry of Finance and Economy (MOFE) was able to determine nonviable spending. In the case of an earthquake, the responsible entity is more likely to be the National Agency of Civil Protection in the Ministry of Defense; its assessment of the extent of the damage will imply what activities and thus spending have become nonviable. If for example an earthquake or flood has damaged facilities, operating expenses are likely to move into the nonviable spending category and can therefore be reallocated for reconstruction or rehabilitation activities. In a pandemic, nonviable expenditures are determined by restrictions to in-person activity. In an economic and financial crisis, nonviable expenditure is likely to be substantially smaller.

To help identify nonviable expenditures in a health crisis or natural disaster, the government could explore using the latest analytics and technology, which are already in wide use in other countries to support post-disaster measures, such as planning of response and triggering of insurance payouts. For example, such technology includes the following:

- **Rapid post-disaster assessment** using catastrophe risk modeling and computation. This is part of the World Bank's Global RApid post-disaster Damage Estimation (GRADE) approach (Gunasekera et al. 2018). GRADE uses event footprint maps (i.e., scientifically sound spatial representations of the degree of hazard intensity in an affected area), modeling of exposed assets (e.g., the population, valuations of existing buildings and infrastructure), and their estimated vulnerability to the hazard to produce outputs that can aid relief agencies and governments during the crucial early period after a disaster. This approach entails some requirements, such as access to reliable building data (e.g., ensuring that assets have carefully recorded location characteristics); but it could offer a rapid and in-depth understanding of what expenditure might have become nonviable as a result of disaster. MOFE would likely require collaboration with the local geospatial agency (ASIG) to identify source data.
- **Satellite technology.** There are many free and paid satellite services available to governments that help determine the extent of damage following disasters. While it is unclear if the benefit of these solutions exceeds the cost, such technology could be used in supporting wider post-disaster financing needs (that is, not only to determine nonviable expenditures, but also to design insurance triggers, understand where the priorities are for financing, and plan response efforts, among many others). There are agencies that might support development of a feasibility study on using such technology in Albania.

Any spending deemed nonviable should be regularly reviewed due to the fluidity of disaster environments and should be updated regularly. For example, some spending may be deemed non-viable for a short period, but will be critical to pick up again as soon as is feasible (like elective surgery). Others might be non-viable in the initial aftermath of the shock, but may be more important to recovery later in the fiscal year. In these cases it may be a matter of short-term pauses, with spending to be reinstated later. As a result, lists of non-viable expenditures should be reviewed and updated on an iterative basis.

In all disasters, maintaining a dynamic record of nonviable expenditure would be helpful. Along with information on the disaster type, geographical location, and severity, such a record could become a useful resource when a similar disaster hits in the future, ensuring that best practices for quickly identifying and rerouting nonviable spending can be followed.

2. Underexecution

Cost potential:

In all countries and in any given year, many parts of government underexecute (spend less than is allocated) on certain aspects of the budget. While ministries of finance are tasked with correcting this inefficiency, it is not always possible; very few countries achieve 100 percent execution of the budget year after year. During a disaster year or when a country is experiencing an external shock, the slack within the budget needs to be rapidly identified to ensure funds do not sit idle when finances are scarce. Governments need to act quickly to identify areas of potential underspending as soon as the crisis commences rather than waiting until the end of the year when the need for finance is less urgent. If areas of potential underexecution can be identified, budget reallocations from this space will, by nature, have a very low cost, since funds would have been unspent regardless. Note that reallocations from areas of underexecution are not completely costless simply because of the difficulty in identifying such areas, meaning that inclusion and exclusion errors will be likely in some cases.

Identifying areas of likely underexecution

Spending by line ministries and other budget institutions throughout the budget year is closely monitored by ministries of finance as a

routine activity to ensure aggregate fiscal discipline and efficient use of public funds. During a crisis, such monitoring should be stepped up to identify possible areas of underexecution. In general, identifying underexecution is more difficult early in the fiscal year, so modeling will be necessary if the crisis occurs early (as was the case with COVID-19). As a first step, past execution performance at the same point in the fiscal year should be compared against current-year performance, disaggregated by line ministry, program, and economic class, to identify any divergences. The presence of significant unallocated funds (e.g., frozen funds, reconstruction fund) in Albania makes this process trickier, since ring-fenced but unallocated funds will not demonstrate poor performance until allocated. Over time, Albania may wish to consolidate the multiple contingencies in order to improve allocative efficiency. Following close scrutiny of the data, early indications of underexecution should be sense-checked with line ministries to ensure more complete information. For example, there may be reasons why a ministry expects a surge in spending under a particular program later in the year. While this may lead to some gaming by line ministries (as is already taking place in Albania), incentives for good and clear planning should be in place (e.g., a "use it or lose it" approach for capital spending to encourage early deferrals to following years if timelines are moving more slowly than planned).

Once this stage is complete, it is likely that all the low- or zero-cost areas of spending will have been cut and reconfigured for crisis response measures. If additional funds are required, it becomes more difficult and costly to identify further areas for cutting. However, there is considerable thinking about allocations 1. that can be done ex ante to save time, limit costs, and facilitate a more streamlined process of budget reallocations. Such an approach is discussed below.

↓ 3. Lower-priority spending

The third area to target is lower-priority spending across discretionary spending areas. For example, even if the pandemic had not prevented in-person training or international travel, these would have been likelier targets for potential cuts than higher-priority spending. Medium-term planning documents can be a useful guide to identifying higher priority spending. Moreover, nondiscretionary spending, such as pensions or regional transfers, should not be considered within this category. What constitutes nondiscretionary spending is generally set out in a country's legal framework.

There are some costs associated with cutting lower-priority discretionary spending, and these can be high if not given due consideration. A number of factors should be taken into account when considering what areas of discretionary spending are of low priority and thus an appropriate target for cuts in the absence of additional cash.

Identifying lower-priority spending

In identifying lower-priority spending that can be cut to facilitate disaster response, the following factors should be considered: the returns of projects, the (in)sufficiency of spending (compared to needs), potential unintended consequences, and levels of expected resistance to cuts. Each of these factors is discussed in turn.

Likely returns to spending

When considering where to find money within the budget, best practice suggests that cuts should target areas where returns are lowest. Projects with high returns (e.g., maintenance of capital projects) should be protected (or governments face the risk of more rapid depreciation and higher costs later down the line), while projects with smaller benefits (e.g., venue hire or vehicle purchasing) should be considered more expendable. In some countries, the financial constraints posed by crises also open up the space and create opportunities to minimize politically motivated spending, which is typically associated with lower returns.

This process entails a clear understanding of the returns to spending, which is almost impossible to arrive at in the midst of a crisis and so should be put in place beforehand. Moreover, it is difficult to achieve such an understanding across the entirety of the budget without a proper appraisal and evaluation system in place. In Albania, the Albanian Financial Management Information System (AFMIS) will become a key source of information for such decision-making—with credible key performance indicators defined for all budget programs—once it is fully up and running.

In the meantime, the government could consider piloting the novel concept of resilience budgeting. Resilience budgeting would require the government to engage in a process of prioritizing budget spending before it is implemented, and for different financing scenarios (whether triggered by a disaster or other constraint to fiscal space). This means having a clear ex ante understanding of the areas within the budget that could be cut if a crisis were to occur (and no additional financing was available). This understanding, which can take many forms, should be agreed between MOFE, the relevant ministries, and possibly even Parliament. In its simplest form, it would distinguish between discretionary spending, which is "nice to have," and essential spending.[16] For example, a project providing flood protection that is prioritized in the national development plan might be classified as essential, whereas the refurbishment of a ministry might be nice to

16.Categories are for illustration only; different categories could be designed and implemented based on need and requirements.

have. More elaborate ranking systems could be developed over time, based on funding scenarios (asking ministries, for example, what their budgets would look like at current funding levels, versus 80 percent funding, versus 70 percent funding). This process of ranking expenditure items could be something line ministries and agencies are required to do prior to submitting their budget request, with MOFE ultimately having the final say. This process, while difficult, would result in a pre-agreed share of spending that is designated as "at risk" in the case of crises. In addition to likely returns and criticality, the three factors discussed below (spending sufficiency, unintended consequences, and expected resistance) should be taken into consideration when trying to identify at-risk spending. It will be necessary to build in structures that prevent budget holders from gaming the system (by ranking a superfluous amount of spending as critical); this could be done for example by setting limits on the amount deemed critical and/or inviting views from external panels of experts.

Sufficiency of spending

As demonstrated in the impact analysis, the (in)sufficiency of spending (as compared to needs) has a direct relationship with the longer-term impacts of reallocations. Hence preexisting levels of sufficiency of government spending by sector should be taken into consideration when planning any new cuts. Sectors deemed to have moderate to severe insufficiency of spending should be relatively protected from the process of budget reallocations. In Albania, the research suggests that health and education are the sectors with the lowest sufficiency of spend compared to observed needs and regional comparators, followed by economic relations and social security, and thus these sectors may warrant a degree of protection in the face of cuts. However, the MOFE and the various line ministries are best placed to determine and rank the sufficiency of spending in each sector. If the government were to identify at-risk spending, (in)sufficiency of spending could play an important role in identifying sectoral focuses.

Avoidance of unintended consequences

In some cases, there will be unintended consequences or knock-on effects from cutting financing to certain projects. These are particularly likely in the case of the capital budget, where the implementing agency is often engaged in contracts that include payment schedules. But they can also occur across all categories of spending. If reducing spending is likely to have financial implications in the form of penalties or arrears, then cuts should be avoided unless the benefits of cutting outweigh the costs. Line ministries and agencies should play a key role in flagging such cuts to the MOFE in advance of any budget reallocations.

For many capital projects, even if contracts do not include explicit penalties, there are likely to be costs associated with delaying projects, such as those relating to depreciation of assets, delays to the investment flow of benefits, and additional costs for the leasing of equipment. Prior to cutting expenditures, information should be gathered on the potential ramification of delays, or "interruptibility"; some expenditures can be deferred for a time with little cost, others not. Knowing which items are in which category in advance would be helpful, and this is a factor that line ministries should take into account when considering at-risk spending.

Levels of expected resistance

One final step that can ease decision-making on budget reallocations is to target spending that is unlikely to be missed, or cuts that will face limited resistance. What is deemed to fall under this category will differ in every country, and a country-specific working definition could be developed. Some examples include projects that have yet to start, since any knock-on costs from canceling are unlikely; however, projects may still have a high expected return, meaning that delays are not costless. Another area commonly drawn from when governments are in need of cash is the budget for vacancies, as was witnessed in Albania. Budget allocations from the vacancies budget are unlikely to be damaging if there is a clear plan for when recruitment will commence. This is not the case in sectors where sufficiency of spending is low, or where national output indicators well below optimal levels (e.g., pupil-to-teacher ratios); recruitment in these areas should continue. Other areas often considered easier to cut are travel, purchase of new vehicles, and the refurnishing of offices; however, country contexts differ, and a country-specific definition should be developed to avoid unintended consequences. Once agreed, if the government were to engage in the process of resilience budgeting, this could be cascaded to line ministries for consideration in determining at-risk spending.

In summary, the framework suggests that the cost of budget reallocations can be minimized if the government looks to exhaust reallocations from nonviable spending first, followed by projected underexecution, before it turns to identifying lower-priority spending (and the many ways that can be defined). Of course, there may be contradictory pressures to cut (or protect) spending based on these different steps (for example, a program may be very slow to execute, but deemed a high priority); these will need to be balanced against each other, and ultimately trade-offs accepted. What is clear is that in most cases, some of the decisions around budget reallocations can take place before a crisis; this approach will reduce the impact of any reallocations since they will be made when there is time to collate and consider evidence more fully through wider engagement across government.

Areas for further research 6

This analysis is among the first contributions to research on the size, frequency, and impacts of budget reallocations—a topic that has to date been insufficiently interrogated. This analysis poses some significant methodological challenges, including how to distinguish between reallocation for emergency purposes versus for other reasons, and how to value the impact of public expenditures that did not take place. The approach adopted here might require further refining, although any approach is likely to require a raft of assumptions, meaning that any final result will ultimately be contestable. The analysis presented in this report can be considered as a first effort, intended to generate discussion and promote further research and a diversity of approaches to answering the question about budget reallocations.

One gap identified within the existing framework is the absence of counterfactuals for other key variables, notably revenue and borrowing. Constructing a counterfactual for only one piece of the fiscal picture (expenditure) makes it very difficult to comment concretely on the role that other fiscal tools have played. Further analysis of this kind should look to develop a more comprehensive set of counterfactuals in order to shed light on the role that different instruments have played in responding to a crisis.

Furthermore, this study focuses only on spending by the central government of Albania and the fiscal year 2020. However, the pandemic has been felt all across Albania, is still having spending ramifications in 2021, and is likely to do so well into the medium term. Further research could take a wider perspective, analyzing the impact on the entirety of the public sector across the medium term. In addition, the research is squarely focused on the global pandemic; however, it could similarly be applied to other disasters in Albania—and potentially have greater relevance, given the unprecedented nature of the pandemic. This section delves into why such issues might be important to scrutinize further, and how further research in this space might be approached.

6.1 Local government

Local government also suffered the budgetary impacts of the pandemic, and further research could consider the resulting implications. The earthquake of 2019 and global COVID-19 pandemic in the following year left severe consequences for local communities in Albania and led to an increase in local spending needs. Yet this increase was not accompanied by similar increases in the available funds for financing of those needs, resulting in an increase in local government deficits. Considering the increasing role of local governments, COVID-19 response could not be fully understood at central government level. However, the analysis included within this report looks at spending by central government units only (71 percent of total spending in 2020) and disregards spending decisions taken by the rest of government. This approach presents an incomplete picture, particularly in light of recent decentralization efforts, which have transferred much of the crisis management role to local governments. Drawing in local government spending could therefore further enrich the analysis. Aggregate analysis suggests that local governments have indeed felt the budgetary impact of the pandemic. As shown in Table 7, local government collected revenues that were 18 percent lower than planned in the initial budget.[17] With limited access to additional finance, local governments will likely have had to reconfigure budgets to identify space for response measures, pushing other spending to one side or potentially building up arrears.

Table 7. Revenues from local government in 2020: Actual compared to planned →

	2020 Original budget	2020 Outturn	Change (%)
Revenues from local government	26,944	21,975	-18%
Local taxes	21,222	16,468	-22%
Property tax	5,354	5,124	-4%
Small business tax	369	384	4%

Source: World Bank utilizing BOOST data.

Further research could incorporate local government in a number of ways. For example, it could (i) adopt an aggregate approach, or (ii) identify one or two case studies at either the regional or municipality level. Adopting an aggregate approach would involve utilizing the existing BOOST data, which contain budget and expenditure data for the 12 regions and the 61 municipalities in Albania; this information is disaggregated to the same level as central government data. While it would be too complex to calculate and apply normal-time deviations to the local government entities, the data could be analyzed by treating the regions as one block and the municipalities as another.

17. Some of the underperformance in revenue is likely attributed to normal-time deviations against targets.

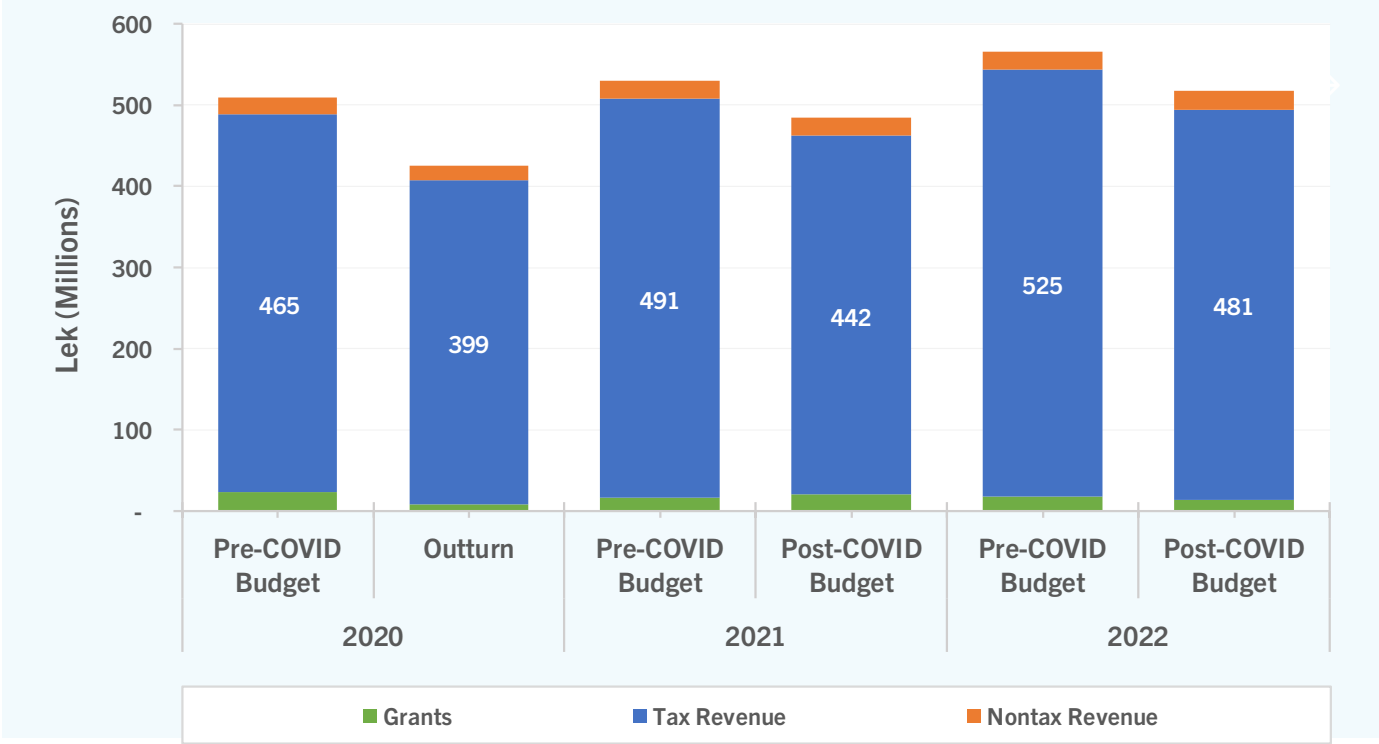
A high-level comparison between local government budgets and actual expenditure in 2020 would provide some indication of the overall impact on regions and municipalities, identifying at an aggregate level the sectoral losers from budget reallocations in 2020.[18] Conducting the analysis in this way would add to the literature on the estimated cost; however, impact would be harder to estimate. Furthermore, any recommendations on the basis of this analysis would have limited reach without the establishment of direct counterparts in local government.

The second approach to incorporating local government, choosing one or two case studies, could undertake a light-touch exercise akin to a scaled-down version of the national study. Analysis could focus on the chosen regions or municipalities to identify how decisions were made to reconfigure the 2020 budget for COVID-19 response; the BOOST data could be utilized, and interviews would be required. This approach would require buy-in from the local governments, but would facilitate the development of region- or municipality-specific recommendations, which could lead to a more effective DRF approach in the face of future shocks in the specific region or municipality chosen. However, this approach is narrower than the aggregate approach, since it is unlikely that the findings and recommendations would be entirely scalable and applicable to other regions or municipalities.

6.2 Medium-term implications of COVID-19

Given the scale and longevity of the crisis, the COVID-19 pandemic is likely to have implications for budgets in Albania for many years to come—well beyond the single year (2020) considered in the analysis. For a multi-year and sizable disaster, focusing on the impact of expenditure in one year is likely to result in some gaps. This is particularly the case in Albania, where according to interviews and the expenditure analysis the government relied heavily on external financing, as well as budgetary reallocations, to finance the COVID-19 response in 2020. In order to meet the financing needs associated with the ballooning deficit (7 percent in 2020), it is likely that there will be budget reallocations across the medium term, compared to pre-COVID plans. In addition, given the GOA's move to introduce a zero primary balance rule in 2023 and the high likelihood that COVID-19 will have an enduring impact on revenue collections, fiscal consolidation will be required to a greater extent than previously planned (see Figure 12).

Figure 14. Revenue forecasts pre- and post-COVID



Source: World Bank based on MOFE 2019, 2020.
Note: Block colors indicate pre-COVID forecasts; dots indicate post-COVID

18. Analysis would need to establish if national government took over any local government responsibilities during the crisis, since this could be a large factor in why local governments enacted certain reallocations. This information could come out of the expenditure analysis but would more likely require dedicated questions during the interviews with the national government.

However, identifying a medium-term robust counterfactual is challenging. This difficulty stems from issues arising in medium-term planning. In Albania and indeed in most countries, medium-term plans are generally not a good predictor of actual spending patterns. In the 2017 Public Expenditure and Financial Accountability assessment, Albania received a D (the lowest score) for "consistency of budgets with previous year's estimates," which assesses the extent to which the expenditure estimates in the last medium-term budget establish the basis for the current medium-term budget (World Bank 2017). This means that the medium-term forecasts produced in late 2019 are unlikely to have materialized exactly as planned had COVID-19 not occurred.

Given the scale of the shock, there may be value in analyzing the aggregate data despite these challenges in order to provide some insight into how the pandemic has impacted the medium-term budgets. Anecdotal evidence from the interviews suggests that there will be large impacts. For example, the Ministry of Infrastructure and Energy reports that it received only 45 percent of its request for funds in the 2021 budget process.[19] This means that 2021 will be mainly focused on fulfilling existing contracts, with only one new project forecast to start. Medium-term plans in Albania span three years into the future; this means that pre-COVID disaggregated expenditure plans and budgets are available through to 2022. If the analysis was extended to include the medium-term budgets, taking into account the aforementioned caveats, the pre-COVID forecast data could be analyzed against post-COVID forecasts. This analysis would be indicative only, demonstrating the deviations on a ministry and programmatic basis. It would not be possible to isolate the changes that occurred specifically as a result of the pandemic without carrying out further interviews.

6.3 Other disasters or crises

COVID-19 is unlike other disasters in a multitude of ways. Its global nature means that the study of the budgetary consequences can be usefully compared across countries, but at the same time, some unique aspects of the pandemic may diminish the findings' relevance for other disaster types or crises more broadly. For example, the fact that COVID-19 impacted the entirety of the country and necessitated far-reaching restrictions on economic and social behavior meant much of the underspending was discounted as nonviable. Such restrictions would be much less common following a more typical disaster such as a drought or flood, or during an external economic and financial crisis. Moreover, because so many countries were affected, concessional financing was probably more readily available for COVID-19 than it would be for a disaster that hit a single country or a region within a country.

Conducting research for a more frequent disaster type—in the case of Albania, a flood or earthquake—would be valuable. It would provide insights into how reallocation decisions are made when options for "free cuts" (nonviable expenditures) are more constrained, and when additional resources need to be channeled to particular locales within the country. Moreover, the picture in 2020 was largely influenced by the fortuitous timing of the Eurobond, and the proposed analysis would consider different debt dynamics that would result in different usage of budget reallocations.

6.4 Processes for allocating additional financing in the wake of emergencies

This research did not consider in detail the "winners" from the reallocation process, or question whether the activities financed were the right choices, or interrogate the processes and criteria by which those decisions were made. Future research could valuably analyze the additional COVID-related expenditures (across different economic classes of spending), and in doing so, consider the approach to reprioritization of the amounts saved through the reallocation process. Different reallocation modalities could be reviewed, including the channeling of funds through (i) general contingency reserves, which typically do not need parliamentary scrutiny regarding how funds are distributed; (ii) disaster funds, which may have more specific criteria regarding how funds are spent; and (iii) agency-specific contingencies, where certain agencies will receive a predefined allocation based on the nature of the disaster. The different modalities offer different advantages and disadvantages in terms of timeliness, predictability, and accountability. Moreover, where data allowed, it would be interesting to estimate the returns from the additional expenditures against the losses from the returns forgone associated with reallocations; this would allow for a fuller assessment of the value for money of budget reallocation instruments and help further refine the reallocation framework. The difficult process of identifying budget reallocations is only worthwhile if funds saved through the triage process are subsequently spent on high-value-for-money activities. This piece of analysis would be facilitated if a disaster budgeting tagging system were in place.

19. The ministry reports that it usually receives 55–60 percent of its budget request.

Annex A List of interviewees

Mr. Gentian Opre, Director, Directorate of Analysis and Budget Programming	Ministry of Finance and Economy
Ms. Xhoana Agolli, Director, Directorate of Budget Management	Ministry of Finance and Economy
Ms. Kesjana Halili, General Director, General Directorate of Public Debt and Foreign Aid Coordination	Ministry of Finance and Economy
Mr. Nikolla Lera, General Director, Directorate of Macroeconomic Policies, Fiscal Affairs and Labour	Ministry of Finance and Economy
Mr. Endrit Lami, Director, Directorate of Macroeconomics and Statistics	Ministry of Finance and Economy
Ms. Alma Beja, General Director, General Directorate of Treasury	Ministry of Finance and Economy
Ms. Aurela Velo, Director of Business Processing	Ministry of Finance and Economy
Ms. Suzana Stefa, Director, Directorate of Public Investment Management	Ministry of Finance and Economy
Ms. Veronika Rusi, Specialist, Directorate of Public Investment Management	Ministry of Finance and Economy
Ms. Fatjona Xhaferri, Specialist	National Civil Protection Agency
Ms. Geraldina Prodani, Secretary General	Ministry of Health and Social Protection
Mr. Saimir Kadiu, Director, Directorate of Budget and Financial Management	Ministry of Health and Social Protection
Ms. Mirela Bimo, Director, Directorate of Budget and Financial Management	Ministry of Education, Sports and Youth
Mr. Florian Nurce, Chief of Sector, Directorate of Budget and Financial Management	Ministry of Education, Sports and Youth
Mr. Gentian Deva, General Secretary	Ministry of Justice
Ms. Mirjana Zisi, Director, Directorate of Budget and Financial Management	Ministry of Justice
Mr. Nuri Laknori, Director, Directorate of Budget and Financial Management	Ministry of Defense
Mr. Agron Vata, Director	Ministry of Agriculture and Rural Development
Ms. Entela Kola, Director of Budget and Financial Management	Ministry of Agriculture and Rural Development
Ms. Viola Haxhiademi, Secretary General	Ministry of Infrastructure and Energy
Ms. Aferdita Berati, Chief of Sector, Directorate of Budget and Financial Management	Ministry of Infrastructure and Energy
Ms. Agathi Kuramano, Director, Department of Policies and Developments in the Field of Civil Service Management	Department of Public Administration
Ms. Arvena Deda, Head of Unit, Good Governance Programmes and Delivery Unit	Department of Public Administration
Ms. Enkela Dudushi, Director, Department of Policies and Institutions Development	Department of Public Administration
Mr. Altin Tanku, Director, Research Department	Bank of Albania
Mr. Erald Themeli, Director, Department of Monetary Policies	Bank of Albania
Mr. Auron Pasha, Executive Director	IDRA
Mr. Erjon Luçi, Economic Expert	Independent

Annex B Elaboration of the methodology

This annex elaborates on the five-pillar methodology briefly explained in Figure 2 (Chapter 2).

Pillars 1 and 2: Approach to landscape and procedural analyses

The purpose of the landscape analysis (pillar 1) was to document the portfolio of financial instruments available to the GOA for financing response to disasters. The analysis drew on a desk review of literature, including a DRF diagnostic recently completed for Albania (World Bank 2020a) and legal frameworks (including the Organic Budget Law, annual budget laws, and other public financial management and disaster-related laws and procedural documents). The instruments were categorized as ex ante financing instruments (those arranged prior to the occurrence of a disaster) or ex post financing instruments (those mobilized once an emergency has occurred), and were further distinguished as those that retain risk on the government's balance sheet or those that transfer it elsewhere (ODA, for example, transfers risk because it is a liability of the donor entity). For each instrument, the literature review collected information on its legal standing, de jure operating procedures (i.e., processes defined in official documents; how instruments operated in practice was explored later in the procedural analysis), GOA institutions involved, and historical usage, and offered some preliminary comments on comparative appropriateness and effectiveness.

The procedural analysis (pillar 2) built on the landscape review to give a clearer picture of which instruments were used in the COVID-19 response over 2020, as well as the de facto procedures around them. This analysis included preparing timelines for the instruments to understand how long they typically take to mobilize and whether that timeline was compressed in the case of COVID-19. Efforts were made to document how the instruments were used over different phases of the emergency (preparation, response, recovery), using the timeline presented in Figure 1; but in practice no clear linear transition from one phase to another was found (for example, in Albania restrictions were scaled back well in advance of what is now considered the first and second peak of infections). Clearer demarcation was possible using the four normative budget acts approved over the course of the year. The key input to this stage of the work was a series of interviews, primarily with MOFE departments, but also with the NCPA and a selection of line ministries. A full list of persons met with is presented in Annex A. In addition, MOFE provided various financial data sets relating to arrears, debt, reserve fund disbursements, ODA, and other areas.

Pillar 3: Approach to counterfactual development

To determine the extent to which COVID-19 led public expenditure in 2020 to deviate from pre-COVID plans, a counterfactual was needed for comparison purposes. This was the third pillar of the methodology. The counterfactual is defined here as a reasonable estimation of what 2020 expenditure outturn would have looked like in Albania had the COVID-19 pandemic not occurred. This estimate is of course hypothetical and cannot be comprehensively tested, since it is impossible to know with complete accuracy how spending patterns would have panned out in Albania (or any country) in the absence of the global pandemic. However, there is a wealth of information and data that can be drawn upon to develop a defendable estimation, including the original 2020 budget, approved in December 2019 (i.e., before COVID-19 was deemed a significant threat to Albania). Yet simply using the original budget as the counterfactual would likely result in an overestimation of the effects of the pandemic on public expenditures, since budgets across the globe are typically not executed as planned even in years when there is no emergency. Therefore, in order to build a more realistic picture, the 2020 expenditure counterfactual was developed by adjusting the original 2020 budget to reflect normal spending execution trends through the application of what is termed here "normal-time deviations."

Normal-time deviations

Normal-time deviations refers to the typical relationship between original budget allocations and what was subsequently spent, disaggregated by ministry, program, and economic classification. Ministries that each year spend exactly as designated in their original allocation have a normal-time deviation equal to zero; regular underspending against budget gives them a negative score and overspending against budget a positive score. This analysis seeks to identify these trends and apply these normal-time deviations to the original 2020 budget to formulate the counterfactual. This approach assumes that there are indeed typical trends to be identified, and that past trends are indicative of future spending patterns. While these assumptions will not hold true for each and every budget line, the approach elaborated below has been developed to ensure these assumptions hold in the majority of cases; interviews with government officials supplement the quantitative analysis to ensure estimates provide a reasonable picture of reality.

There are a variety of ways in which normal-time deviations can be estimated. The approach taken for this analysis is to **calculate the**

average deviation in spending against the original budget over the last six years (2014–19). Deviations were calculated for each ministry, broken down by program and the four major economic expenditure categories.[20] The median has been adopted to avoid skewing the data with outliers, as would be the case if using the mean. When examining disaggregated data across a period of six years, outliers arise for several reasons, among them unforecastable in-year policy changes, shocks (such as the earthquake in 2019), and spending bottlenecks. Applying the median smooths the data by utilizing only the typical trend in the data. Past budget and expenditure data were taken from the publicly available BOOST database; [21] while 10 years of data were available for Albania, the latest six were used to calculate normal-time deviations, since it is assumed that over time governments improve their capacity to execute the budget as planned. All financing sources were included in the analysis, with the exception of (i) foreign financing and (ii) revenue falling outside of the limit. Foreign financing was excluded since in most cases funds from foreign sources cannot be reallocated by GOA for alternative purposes. Revenue falling outside of the budget was excluded since the development of a counterfactual for such revenue is implausible. [22]

Calculating the normal-time deviations for each ministry, broken down by program and the four major economic expenditure categories, produces around 500 lines of data, the majority of which produce relatively conservative figures within a small range. However, in order to control for data anomalies, a couple of rules were instituted:

- Any new programs were assumed to have a normal-time deviation of zero, implying that they spend exactly as budgeted. [23] New programs do not have sufficient data to establish what might be considered a normal trend; thus it was thought best not to manipulate the existing data and to assume that the new programs execute perfectly. This assumption may result in some upward bias, since one could argue new programs are still getting off the ground and may struggle to spend according to plan. However, due to the limited number of new programs (23) in the data set, this rule does not substantially affect the data or results.
- Any normal-time deviations greater than 25 percent, or less than -25 percent, were further scrutinized to determine whether they accurately depicted reality. This quality assurance process resulted in a small number of manual adjustments.[24] Following these adjustments, the average normal-time deviation was -12 percent across underspending budget lines and 11 percent for overspending budget lines.[25] Table B1 provides an illustration of how normal-time deviations differ across ministries, programs, and economic expenditure classifications. It is important to note that both underspending and overspending is normal. Both arise for a plethora of different reasons, including issues relating to foreign funds or changes in project implementation speeds, as well as poor planning, implementation challenges, and poor budgeting.

Table B1. Illustrative normal-time deviations for select programs

Ministry	Program	Normal-time deviations (%)			
		Capital	Personnel	Transfers	Other recurrent spending
Ministry of Agriculture and Rural Development	Drainage and irrigation infrastructure management	0.2	-3.7	-	2.6
Ministry of Culture	Art and culture	23.5	-3.6	22.8	-0.9
Ministry of Justice	Forensic medicine	-15.0	-6.7	-	6.4
Ministry of Infrastructure and Energy	Planning, management, and administration	-16.2	-21.2	31.2	24.2
Ministry of Infrastructure and Energy	Air transport	-68.0	-32.1	-	-61.2

Source: World Bank utilizing BOOST data, 2014–20.; Notes: - = no allocation.

20. Economic classification level 3 aggregates capital, personnel, transfers, and other recurrent spending (which includes goods and services as well as subsidies).
21. The BOOST initiative (https://datacatalog.worldbank.org/group/boost-public-expenditure-database) is a World Bank–wide collaborative effort launched in 2010 to facilitate access to budget data and promote its effective use for improved decision-making processes, transparency, and accountability. Albania is among the 35 countries/subnational governments included in the database.
22. Although all other financing sources were included, adjustments were required to financing from "University, Hospitals and NRC grant," since this money is properly allocated only through the revised budget..
23. New programs are defined here as programs created from 2018 onward.
24. Thirteen normal-time deviations were manually edited.
25. Figures exclude all 0 values.

Applying the normal-time deviations to the budget data enables the development of counterfactual predictions for 2020 outturn (without the pandemic) detailed by ministry, program, and economic spending category. Table B2 provides an illustration of the counterfactual for a selection of ministries and programs.

Table B2. 2020 counterfactual for select ministries and program →

Ministry	Program	Economic spending classification	2020 Original budget (lek)	2020 Counterfactual (lek)
Ministry of Agriculture and Rural Development	04240 Drainage and irrigation infrastructure management	Capital	2,200,000,000	2,203,384,593
		Personnel	252,000,000	242,641,841
		Other recurrent	403,000,000	413,496,879
Ministry of Culture	08230 Art and culture	Capital	579,500,000	715,404,390
		Personnel	550,800,000	530,714,018
		Transfers	137,630,000	168,964,476
		Other recurrent	79,570,000	78,839,608
Ministry of Justice	01130 Forensic medicine	Capital	10,000,000	8,501,335
		Personnel	39,000,000	36,384,712
		Transfers	-	0
		Other recurrent	38,000,000	40,444,041
Ministry of Infrastructure and Energy	01110 Planning, management and administration	Capital	9,500,000	7,956,800
		Personnel	352,456,000	277,737,681
		Transfers	58,000,000	76,075,451
		Other recurrent	130,000,000	161,412,984
Ministry of Infrastructure and Energy	04560 Air transport	Capital	35,000,000	11,184,600
		Personnel	10,560,000	7,175,427
		Other recurrent	9,640,000	3,742,918

Pillar 4: Approach to expenditure analysis

The fourth pillar of the methodology, the expenditure analysis, involves comparing the counterfactual for 2020 with final expenditure from 2020 (drawn from the BOOST data set). This step provides a list (61,724 lines of data) of deviations against plan, analyzed by ministry, program, and economic classification. Projects are included in the expenditure analysis, but interviews are required to pin down the deviations at project level given the limited budgeting at this level.

The adjustment of the counterfactual for normal-time deviations means that no further assumptions or manual adjustments are required at this stage; the analysis has in effect isolated the estimated COVID-19-related deviations. Further disaggregation of the expenditure data set was required for the impact analysis—namely to isolate the underspending that occurred as a result of constrained financing needs following the pandemic, as opposed to underspending that occurred because activities were deemed no longer viable; this is discussed below. But the expenditure analysis presents all underspending across the year due to COVID-19.

It should be noted that the comparison of 2020 expenditures to the counterfactual revealed a large number of programs that overspent—that is, these program received additional financing through the process of budget reallocations. These are not covered in the expenditure analysis, as the focus of the research is on the areas of underspending and the impact of underspending.

Pillar 5: Approach to impact analysis

Valuing public expenditure is notoriously difficult, and valuing public expenditure that did not take place presents additional challenges. Opportunity cost is defined as the loss of other alternatives when one alternative is chosen. In this context it refers to the losses associated with forgoing certain budgeted expenditures in order to reallocate the funds for COVID-19 preparedness, response, or recovery. It is worth clearly stating that **at no point did the team try to estimate the returns associated with the COVID-related expenditures, or to calculate whether the net returns from reallocating funds were higher than not doing so.** The decision to allocate funding to COVID-19 measures is a given, and this analysis aims to quantify the cost of financing those additional measures through reallocating funds, to be compared (for example) against the cost of other financing options.

When planned expenditures do not take place, associated economic and social returns do not materialize. To analyze the losses from forgone expenditures, one needs to estimate the value of that expenditure had the spending gone ahead, and dealing in such hypotheticals is challenging. For example, not all expenditures that were cut would have produced value had they gone ahead, since some expenditure is nonviable or even decreases value. This is particularly true in the wake of a disaster and was perhaps more an issue for the COVID-19 emergency than it would be for more typical disasters; the reason is that the pandemic led to unprecedented government restrictions on economic and social activity, which rendered some planned expenditures temporarily no longer viable (or made them prohibitively expensive). Consider for example the operating costs of government workplaces in Albania; the opportunity cost of redirecting those funds is significantly reduced because those offices were forced to close for a period of time to contain infections. Other examples may include travel costs, or training activities where movements and gatherings were restricted. Even if additional funds were available to finance such activities, they still would not have occurred; the availability of finance was ultimately not a binding constraint. In fact, MOFE explicitly aimed to first cut spending that was no longer viable, recognizing there would be no value to it. Deviations of this type were extracted from the impact analysis to avoid an overestimation of impact.

Assumptions have been made about what constitutes nonviable expenditure by economic classification on the back of findings from the interviews. While the interviews served to give examples of specific spending lines that were cut for viability reasons (versus those that were viable but were cut because resources were needed elsewhere), it was not practical to interrogate each of the 61,724 lines in the expenditure analysis data set in this way. Therefore, rules were adopted for different economic spending classes, as follows:

- For underspending on **other recurrent spending** (which includes goods and services as well as subsidies), the interviews demonstrated that the social and economic restrictions put in place by the government limited the viability of a large share of spending for this category. In most cases, even if additional financing was available, spending would still not have taken place. However, the interviews did also suggest that a small proportion of underspending was the direct result of financing needs elsewhere. For example, in the early stages of the pandemic, procurement was suspended in order to give priority to pandemic-related budget needs for a period of just around three months. Thus 25 percent of underspending from other recurrent spending is assumed to be the result of constrained financing needs following the commencement of the pandemic (the other 75 percent is assumed to be for viability reasons and therefore disregarded).
- For **transfers, 42 percent** of all underspending is deemed to have been cut as a direct result of social and economic restrictions. The largest underspending value under transfers originates from the Property Restitution and Compensation Service program under the Ministry of Justice. The closure of the courts for a significant proportion of the year resulted in significant underspending for the program; the underspending was thus not the result of financial resources being diverted elsewhere, so the analysis disregards the proportionate share of the underspending.
- In the case of **personnel**, although there were some initial recruitment freezes in place that made recruitment practically nonviable, these lasted only for a little over a month, as processes moved online relatively quickly for most recruitment (though some specialist recruitment, e.g., for the army, remained on hold). Thus it is assumed that only a small share of the personnel underspending (**10 percent**) was related to the recruitment pause and nonviable.
- For **capital expenditure**, the analysis assumes only **10 percent** of resulting underspending was nonviable, while 90 percent was due to diversion of financial resources. This assumption is based on the interviews and news reports suggesting that COVID-related restrictions impacted the construction sector less heavily than other sectors, with the reconstruction efforts moving forward too.

Table B3 sets out these assumptions in more detail. These assumptions were overridden if the interviews provided evidence that specific lines of underspending were the result of factors other than financial need; in such cases, specific weights were manually applied to relevant lines to remove such expenditure from the impact analysis (in practice this affected only a handful of capital expenditures, which were manually adjusted). Once nonviable expenditures were discarded, the impact analysis proceeded on two levels: the economy level (i.e., looking at the total quantum of reallocations across all public expenditure in scope, disaggregated by sector) and the program/project level.

Table B3. Weights applied to distinguish viable expenditures only		
Economic class	Weight (portion of underspending used for impact analysis)	Justification
1 Capital	90%	Interviews suggested that COVID-related restrictions impacted the construction sector less heavily than some others, with the reconstruction efforts moving forward as planned. It is assumed that only 10 percent of resulting underspending was nonviable. There are some exceptions to this; for example, underspending related to the Albanian Development Fund (ADF) is discarded in full, and capital spending under MOESY was given a different weight (see below).
2 Personnel	90%	Although there were some initial recruitment freezes that made recruitment practically nonviable, they did not last long, as processes moved online relatively quickly. It is therefore assumed that only a small share (10 percent) of the personnel underspending was the result of nonviable recruitment, corresponding to the share of the year in which recruitment was not possible (one month and a half).
3 Transfers	58%	The share of all underspending deemed not to have occurred as a direct result of social and economic restrictions was 42 percent. The largest underspending amount, in the form of transfers, originates from the Property Restitution and Compensation Service program. The closure of the courts for a significant part of the year resulted in significant underspending for the program; the underspending was not the result of financial resources being diverted elsewhere, and thus the analysis disregards the proportionate share of the underspending. The 42 percent figure is derived from the courts being closed for approximately 30 percent of the year (four months), plus a slowdown in court cases processed through the remainder of the year linked to difficulties in transitioning online.
4 Other recurrent (goods and services/ subsidies)	25%	Procurement was suspended in order to give priority to pandemic-related budget needs for a period of around three months (equivalent to 25 percent of the year). Thus 25 percent of underspending from other recurrent spending has been assumed to be the result of constrained financing needs following the commencement of the pandemic (75 percent disregarded).
Additional manual adjustments		
Albanian Development Fund: 06220 Local and Regional Infrastructure	0%	The program 06220 Local and Regional Infrastructure, under the ADF, underspent by lek 1 billion in 2020. However, this underspending has been disregarded from the analysis and therefore given a weight of zero. These funds were cut only in the last normative budget in late December, implying funds were not reallocated for alternative purposes. Interviews confirmed that the underspending was not the result of funds being needed elsewhere.
Ministry of Education, Sports and Youth: Capital spending	50%	Interviews highlighted that some of the capital underspending by the MOESY was the result of a shift in responsibility; capital works were implemented by the Ministry of Reconstruction, rather than MOESY. A share of the capital underspending realized by the MOESY is therefore in essence not incurring an opportunity cost (since the work was indeed implemented, just in a different budget line). A clear indication of the amount was not provided, so an assumption had to be made; the analysis applied a 50 percent weight in this case.

Source: World Bank.

Valuing public expenditure at the economy-wide/sectoral level

In order to estimate the aggregate value of public expenditure in each sector, the analysis used the economic concepts of marginal value of public expenditure (MVE) and marginal cost of public funds (MCF).

The MVE measures the change in value in the economy from an additional unit of public expenditure. Because public expenditure stimulates private expenditure, which provides an additional stimulus to the economy (termed a multiplier effect), the MVE is usually in excess of 1 (i.e., an additional lek 1 of public expenditure creates more than an additional lek 1 of value in the economy). Unfortunately, estimates of the MVE do not exist for Albania. The analysis therefore relies on the MCF to estimate the marginal value of public finance (Bevan and Cook 2015).

The MCF is defined as the social cost of a tax rate increase that raises an additional unit of tax revenue. This definition implicitly recognizes that taxation is not cost neutral but rather exerts a deadweight burden on the economy due to distortions. Ensor (2016) provides an estimate for the MCF in Albania of 1.15. This estimate is pivotal to the impact analysis because where public expenditure is on average roughly at the "right level," it follows that the average marginal value of public expenditure would be equivalent to the average marginal cost of raising the funds that finance it. In other words, when the level of expenditure is optimized, MVE = MCF = 1.15. In reality, spending is unlikely to be at an optimal level, and the degree of overspending or underspending is likely to differ by sector. For this reason the analysis sought out measures of the optimality of sector spending levels, with the goal of making sector-by-sector adjustments to the estimate of the marginal value of public expenditure.

Various potential approaches to assessing the optimality of sector spending were considered, and in the end a hybrid of three was used. Each involves its own limitations and potential biases, so a combination of approaches was preferred to arrive at a multicriteria assessment:

- First, **interviews with affected line ministry program managers and MOFE** were used as an opportunity to enquire about the impacts of the underspending against plan as demonstrated through the expenditure analysis. From these discussions, it was possible to derive respondents' opinion as to the sufficiency of sectoral expenditures in 2020.
- Second, **consultations with nongovernmental/semi-autonomous actors engaged in public expenditure issues** were held to solicit their views. Nongovernmental organizations (NGOs) such as the Institute for Development, Research and Alternatives (IDRA) as well as the central bank's research team were included. After being introduced to the premise of the research and its preliminary findings, interviewees were asked about public expenditure sufficiency and the relative degrees of sufficiency in different sectors. They were asked to justify their opinions wherever possible by pointing to relevant research and analysis, conducted either by their institution or elsewhere.
- **Comparison with other relevant country spending patterns** offered a third, quantitative approach to ascertaining relative sufficiency of spending. Comparator countries with a similar per capita income to Albania and a similar export profile (major mineral exporters tend to have a markedly different expenditure profile from other exporters) were selected from the Europe and Central Asia region. A final consideration was data availability. Five comparators to Albania in 2019 were found, namely Bulgaria in 2007, Belarus in 2016, Georgia in 2018, Croatia in 2001, and Romania in 2006. For each comparator, the IMF Government Financial Statistics data on expenditure by functions of government were compared to data for Albania in 2019;[26] the goal was to understand where Albania stood, relatively speaking, in terms of sector spending as a share of GDP.

Findings under these three strands of analysis were then translated into a summary assessment of sufficiency across a five-point Likert scale,[27] with ratings of very insufficient, moderately insufficient, optimal, moderately excessive, or very excessive. Of course, different methodologies would have derived different assessments of sufficiency, but assumptions would be required whatever course was taken. The hope is that by laying out all the assumptions used in this research, future investigations will be able to add to the diversity of approaches and strengthen the conclusion.

The Likert scale ratings were translated into adjustments to the marginal benefits of funds estimate, as shown in Table B4. While arguments could be made for changes to this approach, the bands selected are considered reasonable: they mean that spending in a sector with very excessive preexisting levels is less than 1 (i.e., there is a negative rate of return), but in all other cases (where spending is insufficient, optimal, or only moderately excessive) it is greater than 1, which is logically compelling. Finally, the average of the three strands of analysis (two qualitative and one quantitative) was then taken to calculate an estimate of the marginal benefit of forgone spending by sector (after excluding budget lines diverted for feasibility reasons, as discussed above).

26. The IMF Government Financial Statistics database covers 186 countries for a time period of approximately 20 years; it is available at https://data.imf.org/?sk=5804C5E1-0502-4672-BDCD-671BCDC565A9.

27. A Likert scale is a unidimensional scale used by researchers to collect respondents' attitudes and opinions.

Table B4. Translation of Likert scale to marginal benefit of funds adjustments	
Likert scale	Equivalent marginal benefit of funds (estimate)
Very insufficient	MCF + 0.2 = 1.35
Moderately insufficient	MCF + 0.1 = 1.25
Optimal	MCF = 1.15
Moderately excessive	MCF - 0.1 = 1.05
Very excessive	MCF - 0.2 = 0.95

Source: World Bank analysis.
Note: MCF = marginal cost of public funds.

Valuing public expenditure at the program/project level

In addition to the sector analysis, the analysis also considered examples of how specific government projects were impacted. These were intended to be illustrative, and cannot be used to infer any findings for the impact of reallocations overall. The specific project and program examples were selected based on availability of relevant information. Three different approaches were adopted, looking at different aspects of project-level impact:

- A cost-benefit analysis (CBA). This was based on assessments done for projects in the education sector to derive a monetary value of the benefits forgone (relative to the costs). Rather than conducting a CBA from scratch, sector experts instead relied on existing government appraisal documents (namely project plans and pre-funding reviews), in addition to reviewing estimates from comparable CBAs for similar programs. Details on the approach and results are presented in Annex C.
- A short desk review on the impacts on the achievements of program targets. This was carried out in one sector (defense), through a review of the 2020 Ministerial Monitoring Report and interviews.
- A case study looking at the impact of reallocations on a project in the social protection sector. This aimed to demonstrate the potential impact of co-financing arrangements with donors and drew on World Bank project appraisal and review documents.

Annex C Impact of higher education cuts

This annex sets out the cost-benefit analysis methodology used to estimate a monetary value for the impact of postponing two reconstruction projects due to a cut in the resources allocated to the Ministry of Education, Sports and Youth, and the reassignment of these resources to COVID-19-related needs.

The analysis describes the likely opportunity cost of cutting planned expenditure due to budget decisions that were made in light of the COVID-19 pandemic. The CBA is based on the actual contracted costs of the reconstruction projects and makes economic assumptions on forgone benefits to derive reasonable estimates of the likely net costs to Albania of project delays.

The CBA assumptions are based on information provided by the MOESY, as well as other data sources; they aim to be as close to reality as possible, reasonable, and conservative in terms of likely benefits. Different assumptions could be made that would alter the CBA results. However, given the likely variability in the plausible range for the key assumptions, it is not likely that the CBA results would vary significantly. The results are set out in detail, both to serve as useful examples for the government and to encourage evidence-based decision-making.

The CBA methodology quantified the likely costs and benefits accruing to Albania over 15 years as a result of the delay in issuing contracts for the following two projects:

- Reconstruction of buildings at the Faculty of Civil Engineering and Architecture at the Polytechnic University of Tirana
- Reconstruction works for the Faculty of Bioengineering and Food at the Agricultural University, Tirana

Impact of the COVID-19-induced delay on costs

The start of both projects was delayed by a year (from 2020 to 2021), and a further delay in executing the contracts in 2021 has resulted in lower costs being incurred in the first year under the contracts, in turn resulting in a slower time profile of contract spending. The cost analysis is set out in Table C1.

Table C1. Change in works cost profile due to the delay in MOESY projects

Year	Polytechnic University Faculty					Agricultural University Faculty				
	Original (pre-COVID)		Post-COVID			Original (pre-COVID)		Post-COVID		
	Lek, millions	Cost Share	Lek, millions	Cost Share	Change in costs	Lek, millions	Cost Share	Lek, millions	Cost Share	Change in costs
2020	250	56%	0	0%	-250	150	73%	0	0%	-150
2021	134	30%	125	28%	-9	56	27%	75	36%	19
2022	66	15%	259	58%	193	0	0%	103	50%	103
2023	0	0%	66	15%	66	0	0%	28	14%	28
2024	0	0%	0	0%	0	0	0%	0	0%	0
Total cost	**450**		**450**		**0**	**206**		**206**		**0**

Source: World Bank. ; Note: hyphen = 0.

The profile for costs in the CBA is based on the estimation of the costs[28] for the implementation of the projects, which were approved by the Ministry of Finance in 2020 on the following basis:

- The Polytechnic University project is to be realized within a three-year term and financed from the state budget in the amount of lek 450 million.[29]
- The Agricultural University project is to be completed within 18 months starting from when the construction site is at the company's disposal, at a total cost to the state budget of lek 206 million.[30]

Impact of the COVID-induced delay on project benefits

The delay in starting both projects meant that the benefits for the reconstruction of the university buildings are realized partially in year 2023 and in full only from 2024, rather than in full from 2022 in the scenario where there was no COVID-induced delay. This means a loss of more than two years of benefits.

The CBA quantifies three benefits whose realization is deferred due to the delay in completing the projects: (i) earnings resulting from students completing their studies and taking up employment; (ii) private sector profits from consumer spending out of graduating students' earnings; and (iii) government revenues from income taxes from graduating students' earnings.

The principal benefit quantified is a standard one in education CBAs, namely the human capital benefits arising from undertaking education—in this case higher education. The other two quantified benefits are indirect benefits that accrue to society (private and public sectors) as a result of additional incomes being generated. The direct earnings loss is estimated to account for two-thirds of the total quantified economic loss, or forgone/delayed benefits from the investment.

The estimation of the forgone benefits (losses due to COVID-19) is conservative in a number of ways:

- First, the loss of graduate incomes is quantified over only 15 years, rather than a full working lifetime of 30–40 years.
- Second, the full range of likely indirect losses—for example, the full impact of expenditure and consumption multipliers—is not included.
- Third, wider social and societal impacts—such as the broader benefits of a more educated population, improved social cohesion, greater work productivity—have not been included in the analysis, given the conceptual and methodological difficulties in estimating such costs.

This conservative approach means that the CBA likely significantly underestimates the true impact of COVID-19 resulting from the delay in MOESY capital spending in Albania.

Tables C2 and C3 set out the estimated benefits in the no-COVID and COVID scenarios respectively.

Table C2. Estimated project benefits (with COVID-19) →

Estimated project benefits (pre-COVID)	2020	2021	2022	2023	2024–33	2034	TOTAL
	Year 1	Year 2	Year 3	Year 4	Years 5–14	Year 15	
Numbers of university graduates							
Polytechnic University Architecture & Civil Engineering Faculty students	774	774	911	911	911	911	13 391
Polytechnic University Faculty graduates	-	-	740	871	871	871	11 192
Agricultural University Biotech & Food Faculty students	844	844	844	844	844	844	11 192
Agricultural University graduates	-	-	333	370	370	370	4 773

28. In addition to publicly financed costs, each project includes a contribution from the university, which is viewed as a transfer within the Albanian private sector (and hence a nil net cost) in the CBA.

29. "General Information for the Implementation of the Investment," Polytechnic University of Tirana.

30. Offer Form, Cost of Works for the University of Agriculture, Tirana.

Table C2. Estimated project benefits (with COVID-19) →							
Estimated project benefits (pre-COVID)	2020	2021	2022	2023	2024–33	2034	TOTAL
	Year 1	Year 2	Year 3	Year 4	Years 5–14	Year 15	
University graduates—additional earnings							
Additional earnings (lek, millions)							
Additional earnings from Polytechnic University graduates	-	-	390.72	459.88	459.88	459.88	5909.26
Additional earnings from Agricultural University graduates	-	-	139.86	155.40	155.40	155.40	2004.66
Benefit no. 1: Total additional earnings	-	-	530.58	615.28	615.28	615.28	7913.92
Second round (multiplier) economic benefits of additional earnings (lek, millions)							
Expenditure from Polytechnic University graduates earnings	-	-	214.90	252.93	252.93	252.93	3250.09
Expenditure from Agricultural University graduates earnings	-	-	76.92	85.47	85.47	85.47	1102.56
Total expenditure from graduate earnings	-	-	291.82	338.40	338.40	338.40	4352.66
Profits/earnings from Polytechnic graduate spending	-	-	42.98	50.59	50.59	50.59	650.02
Profits/earnings from Agricultural University graduate spending	-	-	15.38	17.09	17.09	17.09	220.51
Benefit no. 2: Additional profits from graduate earnings	-	-	58.36	67.68	67.68	67.68	870.53
Additional government revenues (lek, millions)							
Additional income taxes from University graduate earnings	-	-	132.65	153.82	153.82	153.82	1978.48
Additional indirect taxes from University graduate earnings	-	-	72.95	84.60	84.60	84.60	1088.16
Benefit no. 3: Additional government revenues	-	-	205.60	238.42	238.42	238.42	3066.64
Total estimated monetary benefits (lek, millions)	-	-	794.5	921.4	921.4	921.4	11851.10
Total estimated monetary benefits (US$, millions)	-	-	7.68	8.90	8.90	8.90	114.50

Source: World Bank analysis based on student data provided by MoEYS.
Note: hyphen = 0.

Table C3. Estimated project benefits (with COVID-19) →								
Estimated project benefits (post-COVID)	2020	2021	2022	2023	2024	2025-2033	2034	TOTAL
	Year 1	Year 2	Year 3	Year 4	Year 5	Years 6–14	Year 15	
Numbers of university graduates								
Polytechnic University Civil Engineering Faculty students	774	774	911	911	911	911	911	13 391
Polytechnic University graduates	-	-	-	-	740	871	871	9 450
Agricultural University Biotech & Food Faculty students	844	844	844	844	844	844	844	9 450
Agricultural University graduates	-	-	-	167	371	371	371	4 248
University graduates—additional earnings								
Additional earnings (lek, millions)								
Additional earnings from Polytechnic University graduates	-	-	-	-	390.7	459.9	459.9	4989.50
Additional earnings from Agricultural University graduates	-	-	-	69.9	155.8	155.8	155.8	1783.95
Benefit no. 1: Total additional earnings	-	-	-	69.93	546.54	615.70	615.70	6773.45
Second round (multiplier) economic benefits of additional earnings (lek, millions)								
Expenditure from Polytechnic graduates earnings	-	-	-	-	214.90	252.93	252.93	2744.23
Expenditure from Agricultural University graduates earnings	-	-	-	38.46	85.70	85.70	85.70	981.17
Total expenditure from graduate earnings	-	-	-	38.46	300.60	338.63	338.63	3725.40
Profits/earnings from Polytechnic graduate spending	-	-	-	-	42.98	50.59	50.59	548.85
Profits/earnings from Agricultural University graduate spending	-	-	-	7.69	17.14	17.14	17.14	196.23
Benefit no. 2: Additional profits from graduate earnings	-	-	-	7.69	60.12	67.73	67.73	745.08
Additional government revenues (lek, millions)								
Additional income taxes from university graduate earnings	-	-	-	17.48	136.64	153.92	153.92	1693.36
Additional indirect taxes from university graduate earnings	-	-	-	9.62	75.15	84.66	84.66	931.35

Table C3. Estimated project benefits (with COVID-19)								
Estimated project benefits (post-COVID)	2020	2021	2022	2023	2024	2025-2033	2034	TOTAL
	Year 1	Year 2	Year 3	Year 4	Year 5	Years 6–14	Year 15	
Benefit no. 3: Additional government revenues	-	-	-	27.10	211.78	238.58	238.58	2624.71
Total estimated monetary benefits (lek, millions)	-	-	-	104.7	818.4	922	922	10143.25
Total estimated monetary benefits (US$, millions)	-	-	-	1.01	7.91	8.91	8.91	98

Source: World Bank analysis based on student data provided by MoEYS. ; Note: hyphen = 0.

The assessment and quantification of benefits uses several assumptions; these are detailed in Table C4.

Table C4. Assumptions made in the quantification of benefits		
Element of the analysis	Data used/assumption	Source
Polytechnic University & Agricultural University Faculty student numbers	Actual 2020 and projected 2021–23 student numbers	Ministry of Education, Sports and Youth
Employment rate of Polytechnic graduates	Assumes 88 percent employment rate in first year post-graduation; assumes such graduates remain employed	Polytechnic University Careers Office
Employment rate of Agricultural University graduates	Assumes 84 percent employment rate in first year post-graduation; assumes such graduates remain employed	Agricultural University Careers Office
Polytechnic graduate earnings	Average earnings of lek 600,000 per year (€480/month)	Albanian statistics on employment & income
Agricultural University graduate earnings	Average earnings of lek 500,000 per year (€400/month)	Albanian statistics on employment & income
Average propensity to consume out of earned income	55 percent of graduate earnings spent on marketable goods	Analyst assumption
Average private sector profit rate	20 percent gross (pre-tax) profit rate	Analyst assumption
Average personal income tax rate	25 percent tax rate	Analyst assumption
US$/lek exchange rate	US$1 = lek 103.5	Average 2020 exchange rate
Discount rate used in CBA	3.5 percent	Analyst assumption

The calculation of the net costs (costs less benefits) of delaying the reconstruction on a discounted and undiscounted basis is shown in Table C5.

The CBA shows that using a discount rate of 3.5 percent, total discounted net costs of the delay in investment in the two projects were just under lek 1,500 million, equivalent to US$14.3 million. On an undiscounted basis, costs amounted to 2.6 times the cost of the public sector's share of the investment.

Total discounted investment costs fell slightly (by lek 28 million) as a result of the delay in undertaking the investment. The undiscounted total loss of human capital (proxied by reduced earnings) is estimated to be lek 1,140 million, with a further loss of private sector profits and government revenues of lek 568 million; thus the total loss to the Albanian economy is lek 1,708 million (US$16.5 million). As noted above, the calculated direct and indirect losses are conservative, as the calculations do not take into account the full range of economic losses arising from the delayed graduation (reduced productivity, creativity, etc.) or the associated social losses (reduced community- and household-level benefits from fewer graduates in society).

Table C5. Cost-benefit calculations									
	Change in project costs (post-COVID minus pre-COVID)		Change in project benefits (post-COVID minus pre-COVID)						
			First round	Second round effects					
Year	Total investment costs	Discounted investment costs	Benefit 1: Total additional graduate earnings	Benefit 2: Additional private sector profits	Benefit 3: Additional government revenues	Total investment benefits	Discounted investment benefits	Undiscounted net costs	Discounted net costs
1	-400	-386.473	0	0	0	0	0	400	386.473
2	10	9.335	0	0	0	0	0	-10	-9.335
3	296	266.975	-530.58	-58.364	-205.6	-794.544	-716.633	-1090.544	-983.608
4	94	81.916	-545.348	-59.988	-211.323	-816.659	-711.671	-910.659	-793.587
5	-	0	-68.738	-7.561	-26.636	-102.936	-86.669	-102.936	-86.669
6	-	0	0.42	0.046	0.163	0.629	0.512	0.629	0.512
7	-	0	0.42	0.046	0.163	0.629	0.494	0.629	0.494
8	-	0	0.42	0.046	0.163	0.629	0.478	0.629	0.478
9	-	0	0.42	0.046	0.163	0.629	0.461	0.629	0.461
10	-	0	0.42	0.046	0.163	0.629	0.446	0.629	0.446
11	-	0	0.42	0.046	0.163	0.629	0.431	0.629	0.431
12	-	0	0.42	0.046	0.163	0.629	0.416	0.629	0.416
13	-	0	0.42	0.046	0.163	0.629	0.402	0.629	0.402
14	-	0	0.42	0.046	0.163	0.629	0.389	0.629	0.389
15	-	0	0.42	0.046	0.163	0.629	0.375	0.629	0.375
Totals (lek, millions)	-	-28.25	- 1 140.47	-125.45	-441.93	- 1 707.85	- 1 510.57	- 1 707.85	- 1 482.32

Source: World Bank.; Note: hyphen = 0.

References

Auriol, E., and M. Warlters. 2009. "The Marginal Cost of Public Funds and Tax Reform in Africa." TSE Working Paper 09-110, Toulouse School of Economics. https://www.tse-fr.eu/sites/default/files/medias/doc/wp/dev/wp_dev_110_2009.pdf.

Auriol, E., and M. Warlters. 2012. "The Marginal Cost of Public Funds and Tax Reform in Africa." Journal of Development Economics 97 (1): 58–72. https://www.sciencedirect.com/science/article/abs/pii/S030438781100006X.

Batini, N., Eyraud, L., Forni, L., and A. Weber. 2014. Fiscal Multipliers: Size, Determinants, and Use in Macroeconomic. Washington, DC: IMF. https://www.imf.org/external/pubs/ft/tnm/2014/tnm1404.pdf

Benson, Charlotte, and Edward J. Clay. 2004. Understanding the Economic and Financial Impacts of Natural Disasters. Washington, DC: World Bank. https://openknowledge.worldbank.org/handle/10986/15025.

Bevan, David, and Samantha Cook. 2015. "Public Expenditure Following Disasters." Policy Research Working Paper 7355, World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/22240.

Bündnis Entwicklung Hilft and IFHV (Ruhr University Bochum—Institute for International Law of Peace and Armed Conflict). 2019. "World Risk Report 2019." https://reliefweb.int/sites/reliefweb.int/files/resources/WorldRiskReport-2019_Online_english.pdf.

Clarke, Daniel, Olivier Mahul, Richard Poulter, and Tse Ling Teh. 2016. "Evaluating Sovereign Disaster Risk Finance Strategies: A Framework." Policy Research Working Paper 7721, World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/24637.

Dahlby, B. 2008. The Marginal Cost of Public Funds: Theory and Applications. Cambridge, MA: MIT Press.

Ensor, W. 2016. "Global Tax Structures and the Marginal Cost of Funds." Master's thesis, Clemson University Graduate School. https://tigerprints.clemson.edu/cgi/viewcontent.cgi?article=3478&context=all_theses.

EU (European Union), Government of Albania (GOA), UN Albania, and World Bank. 2020. "Post-Disaster Needs Assessment (PDNA). Volume A Report." Tirana. https://reliefweb.int/sites/reliefweb.int/files/resources/albania_post-disaster_recovery_a_v9.0.pdf.

Floodlist. 2021. "Albania—Families Evacuated after Floods in North." January 10, 2021, http://floodlist.com/europe/albania-floods-january-2021#:~:text=In%20Durr%C3%ABs%20County%2C%208%20families,in%20Durr%C3%ABs%2C%20Kruj%C3%AB%20and%20Shijak.

Ghesquiere, Francis, and Olivier Mahul. 2010. "Financial Protection of the State against Natural Disasters: A Primer." Policy Research Working Paper 5429, World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/3912

Gunasekera, Rashmin, James Daniell, Antonios Pomonis, Rodrigo Andres Donoso Arias, Oscar Ishizawa, and Harriette Stone. 2018. "Methodology Note on the Global RApid Post-disaster Damage Estimation (GRADE) Approach." Global Facility for Disaster Reduction and Recovery, Washington, DC. https://www.gfdrr.org/en/publication/methodology-note-global-rapid-post-disaster-damage-estimation-grade-approach-2018.

IMF (International Monetary Fund). 2016. "Managing Budgetary Virements." Prepared by Sandeep Saxena and Sami Yläoutinen. https://www.imf.org/external/pubs/ft/tnm/2016/tnm1604.pdf.

IMF (International Monetary Fund). 2020. "First Post-Program Monitoring Staff Report." IMF, Washington, DC.

IMF (International Monetary Fund). 2021. "Database of Country Fiscal Measures in Response to the COVID-19 Pandemic." https://www.imf.org/en/Topics/imf-and-covid19/Fiscal-Policies-Database-in-Response-to-COVID-19.

MOFE (Ministry of Finance and Economy). 2012. "On Standard Procedures on Implementation of Budget." Government of Albania, Tirana.

MOFE (Ministry of Finance and Economy). 2018. "On Standard Procedures on Implementation of Budget." Government of Albania, Tirana.

MOFE (Ministry of Finance and Economy). 2021a. "Report on the Stock of Arrears up to December 2020 and Important Developments from FY2019." MOFE Fiscal Risks Unit. Unpublished.

MOFE (Ministry of Finance and Economy). 2021b. "Reserve Fund Report." Unpublished.

National Assembly. 2008. Law No. 9936 Date 26.06.2008 on Management of Budgetary System in the Republic of Albania.

Government of Albania, Tirana.

National Assembly. 2016. "For Some Addings and Amendments on the Law no. 9936 Dated 26.06.2008 'On Management of Budgetary System in the Republic of Albania (Amended).'" Government of Albania, Tirana. https://financa.gov.al/wp-content/uploads/2017/11/LOB_i_ri_nr._57_dt_02.06.2016_-_MIRATUAR_ne_KUVEND_ENGLISH.rtf.

National Assembly. 2019. Law on Civil Protection. Government of Albania, Tirana.

National Assembly. 2020. "Some Additions and Amendments to Law No. 9936, Dated 26.6.2008, 'On the Management of the Budget System in the Republic of Albania,'" Amended. Government of Albania, Tirana.

OECD (Organisation for Economic Co-operation and Development). 2021. "The COVID-19 Crisis in Albania." Updates from April 27, 2020, to January 31, 2021. OECD, Paris. https://www.oecd.org/south-east-europe/COVID-19-Crisis-in-Albania-archive.pdf.

World Bank. 2014. Financial Protection against Natural Disasters: An Operational Framework for Disaster Risk Financing and Insurance. Washington, DC: World Bank. https://openknowledge.worldbank.org/handle/10986/21725.

World Bank. 2017. "Albania: Public Expenditure and Financial Accountability (PEFA) Performance Assessment Report." World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/29749.

World Bank. 2020a. "Disaster Risk Finance Diagnostic Albania." World Bank, Washington, DC. https://www.financialprotectionforum.org/publication/disaster-risk-finance-diagnostic-albania.

World Bank. 2020b. Global Economic Prospects: Slow Growth, Policy Challenges. Washington, DC: World Bank.

World Bank. 2020c. "Public Expenditure Review: Disaster Response and Rehabilitation in the Philippines." World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/35064.

World Bank. 2021a. Macro Poverty Outlook: Europe and Central Asia. Washington, DC: World Bank. https://pubdocs.worldbank.org/en/107191492012467509/mpo-eca.pdf.

World Bank. 2021b. "Restructuring Paper on a Proposed Project Restructuring of Social Assistance Modernization Project." World Bank, Washington, DC. https://documents1.worldbank.org/curated/en/395191614243318919/pdf/Disclosable-Restructuring-Paper-Social-Assistance-Modernization-Project-P122233.pdf.

World Bank and GFDRR (Global Facility for Disaster Reduction and Recovery). 2014. "Financial Protection against Natural Disasters: An Operational Framework for Disaster Risk Financing and Insurance." World Bank, Washington, DC. https://www.gfdrr.org/en/publication/financial-protection-against-natural-disasters-operational-framework-disaster-risk.

WORLD BANK GROUP

Schweizerische Eidgenossenschaft
Confédération suisse
Confederazione Svizzera
Confederaziun svizra

Swiss Confederation

Federal Department of Economic Affairs,
Education and Research EAER
State Secretariat for Economic Affairs SECO