

# A hidden cost of disasters: **the opportunity cost of post-disaster budget reallocations**

*A synthesis of research in four countries*

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# Outline

1. Purpose and scope
2. Methodology design
3. Case study findings, and what we learnt about budget reallocations
4. Select recommendations

# 1. Purpose and scope

*The previous presentations looked at how COVID affected wider health expenditures, but what about the impacts felt on other sectors?*

# Purpose and scope

- Filling an evidence gap on the wider opportunity cost of emergency budget reallocations *between* sectors and programmes
- The **pattern** of reallocations and their **impact** has been overlooked in the literature:
  - Reallocations are not well documented in routine budget documents.
  - Rationale forgotten once the crisis abates.
- **Four country studies** looking at reallocations in response to **COVID-19**
  - Ethiopia, Albania (national); Pakistan, South Africa (national + provinces)
- **First fiscal year** affected by the pandemic (differing FY mean varying periods of impact **4-12m**)

# Headline findings

- To finance COVID expenditures and makeup for revenue shortfalls, funding for sectors including irrigation and education were particularly negatively affected.
- Using budget reallocations to finance disaster response **incurs a significant opportunity cost.** (<2% GDP)
- The opportunity cost of reallocations is largely overlooked, and therefore opens up a whole discussion on how we can **limit those costs.**

But first, how did we get there?





## **2. Methodology design**



# Methodological pillars

## 1. Counterfactual development

- Best-guess estimation of public expenditure outturns in a scenario in which the epidemic did not occur.
- The outturns counterfactual can be established through utilising the original budget (pre-pandemic) and assessing deviations expected in 'normal' years.

## 2. Expenditure analysis

- Comparison of actual expenditure against the counterfactual.
- Focus on the incidence of spending cuts, identifying the 'winners' and 'losers', capturing changes on a sectoral basis, and in administrative, economic and functional/ programmatic classifications.

## 3. Procedural analysis

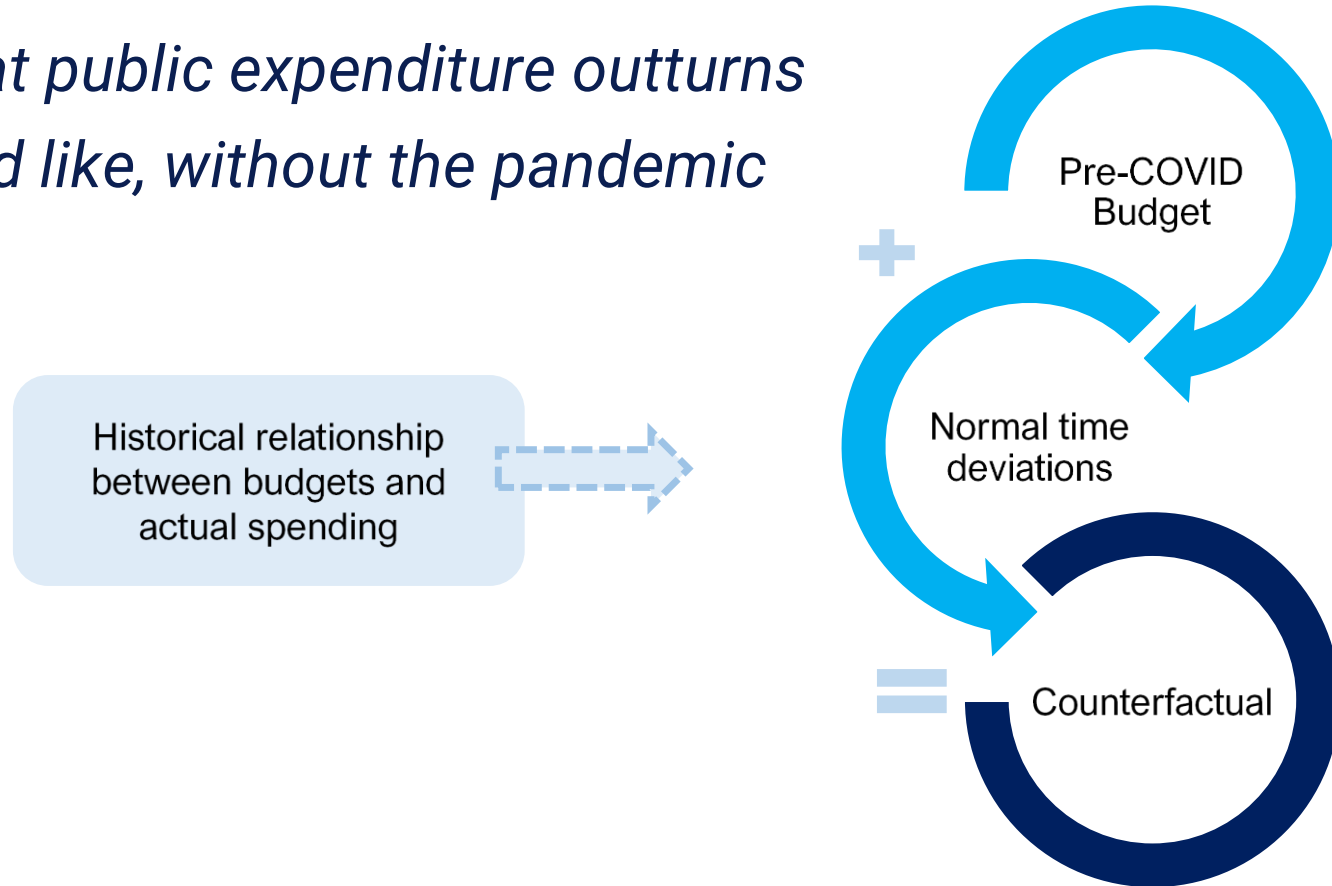
- Review of the legal and institutional framework, alongside any guidelines on budgeting and expenditure procedures.
- Kils with Government on the processes by which budget allocation decisions are made, mapped across the emergency cycle.

## 4. Impact analysis

- Economic analysis of the estimated impact of cut or delayed expenditures in terms of social and economic returns forgone.
- Analysis at the aggregate/sectoral level, and for a few key budget programmes for illustrative purposes.

# i) Counterfactual development

*Estimation of what public expenditure outturns would have looked like, without the pandemic*



## ii) Expenditure analysis

- Comparison of detailed outturn data with the counterfactual
- Able to identify ‘winners’ and ‘losers’ at sector and programme level
- Analysis focuses on the ‘losers’ as this is where returns were foregone.

## iii) Procedural analysis

- Qualitative analysis was required to understand the processes around how, when and why budget reallocations were made
- KIIIs differed across the countries, but followed the same structure, exploring the budget decisions in preparation, response, and recovery phases

## iv) Impact analysis

*Opportunity cost in this case is the cost to economic output of not funding the thing that the budget was originally intended for.*

### **Challenges:**

- The ability to value public expenditures: hindered by the absence of competitive markets for the goods and services governments usually provide.
- Determining (non)viable expenditure during covid-19

### **Multiple Approaches:**

- **Fiscal multiplier** @ economy level, in Ethiopia, Pakistan and South Africa
- **Marginal cost of funds/ marginal benefit of public expenditure** @ sector level, in Albania and Ethiopia
- **Cost Benefit Analysis** for select projects in Albania and Ethiopia



## **3. Case study findings**

and what we learnt about budget reallocations as a financing instrument for disasters



# Budget reallocations are a widely used instrument for financing disaster costs

- Total “Budget cuts” (underspends against the counterfactual) equivalent to **5-7% of annual expenditure** in the first FY of COVID impact
  - Some of this variation is driven by difference in budget structures (volume of reallocations increases at more granular level of analysis) + differing FYs
- **Sizable**, when compared against COVID-19 spending
  - (cuts  $\approx$  93% of COVID spending in Albania, 40% in Ethiopia and Pakistan; 18% in South Africa).

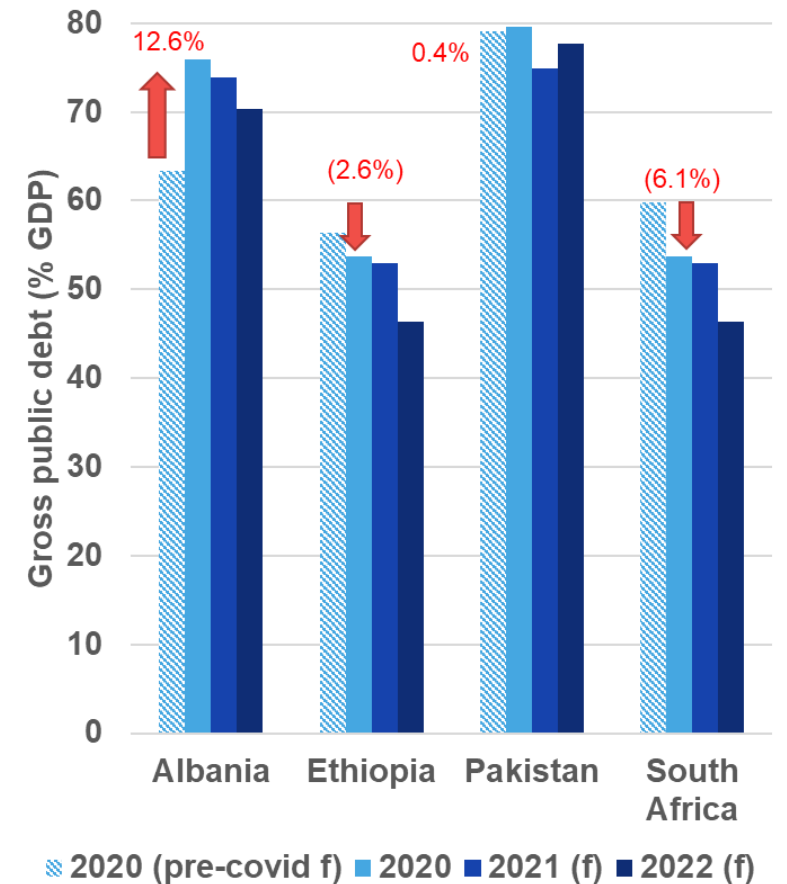
# The incidence of budget reallocations varies

- No sign of “**across the board**” cuts
- **Recurrent** budgets cut more severely than capital budgets
  - larger volumes of non-viable spending, some continuation of construction throughout lockdowns.

Net Winners	Net Losers
Health ( <i>all</i> )	Education ( <i>E, SA, A</i> )
Social protection ( <i>all</i> )	Irrigation ( <i>E, P</i> )
Finance & economy ( <i>A, P, S</i> )	Culture and Sports ( <i>E, SA</i> )
Disaster mgmt. authority ( <i>P</i> )	Election prep ( <i>E, SA</i> )
	Defense ( <i>A</i> )
	Tourism ( <i>SA</i> )
	Disaster mgmt. authority ( <i>E</i> )

# Scale relates to availability of other instruments

- **Appetite for borrowing varied:** Ethiopia, Pakistan and South Africa, all had **debt sustainability** concerns going into 2020; Only Albania was able to increase borrowing in response to COVID.
- The study governments didn't use/have **disaster funds**; and **contingency budgets** were often depleted.
- ODA was promised but **slow to materialise**, and inequitably distributed:
  - COVID ODA/capita: \$104 Albania , \$81 South Africa, \$9 Ethiopia, \$15 Pakistan (CDP, 2021)
- This **absence of other financial instrument options** underpinned the need for reallocations



Data from IMF

# Most reallocations incur an opportunity cost

- There is a natural limit to “free cuts” (non-viable)
- **Opportunity cost of reallocations (%GDP):**  
ZA: 2%; PK 1%; AL 0.8%; ET 0.5%
- But caution comparisons: impact methodology; how non-viable expenditures were treated; FY/time period.
- **Opportunity cost multiple** for budget reallocations is **1.2–1.6**, meaning each dollar mobilised incurs an opportunity cost of \$1.20–\$1.60.

*Budget cuts of 5-7% of expenditure, had an **opportunity cost of 0.5 – 2% of GDP.***

# Most reallocations incur an opportunity cost

## Drivers of impact:

- capital/recurrent mix;
- sectoral incidence;
- sufficiency of pre-crisis public expenditure;
- predominance of “non-viable spending”

# Speed is a primary advantage

- Budget reallocations were the **quickest of the financing instruments** deployed for COVID
- This makes reallocations useful for financing the **immediate response**, and potentially acting as a useful **stopgap**
- **Virements tend to be quicker but less flexible** than supplementary budgets.
- **Flexible workarounds:** Ethiopia vireing into its contingency budget, Albania fast-tracking the supplementary budget preparation to 2-3 days

# Criteria not transparent or formalised

- Each country has reallocation rules which were adhered to
- But criteria for decided **what** should get cut and what should be protected was **not explicit or transparent**
- Factors considered included execution performance, non-financial performance, viability given COVID restrictions.
- **MOF driven** process; with some wider sector engagement in later stages.



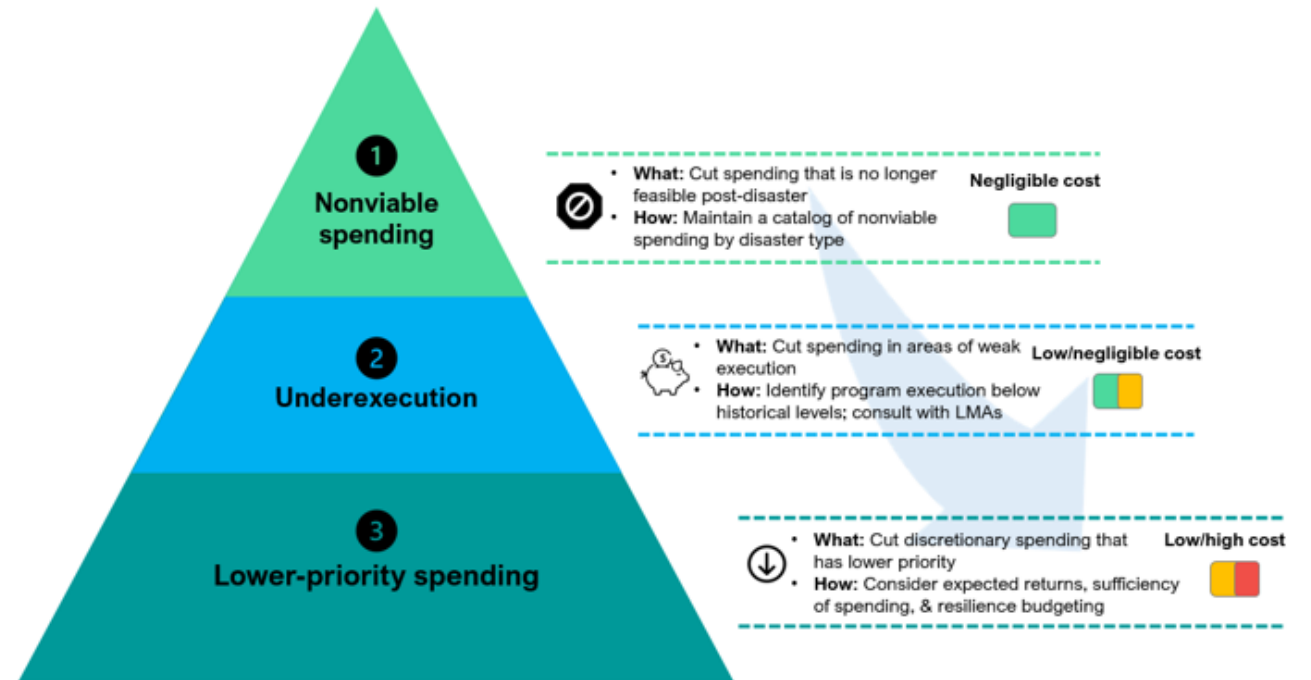
## **4. Select recommendations**



# Recommendations

## 1. Develop an *ex-ante* framework for reconfiguring budgets in the wake of a disaster

- Framework would set out where budget resources could be freed up under different disaster scenarios
- Avoid indiscriminate across-budget expenditure cuts and minimise the unintended negative consequences from delayed or cancelled expenditures.



Source: World Bank (2021). Note: LMAs = line ministries and agencies.

# Recommendations

## **2. Improve transparency around budget reallocations and crisis financing**

- More detail on how budgets have been reallocated and rationale for changes, in conjunction with audit institutions

## **3. Develop rules to guide the appropriation to, and use of, contingency funds**

- Calculate the appropriate contingency allocation amounts (linked to expected losses) & strengthen rules to guide their usage and replenishment.

## **4. Expand and diversify the risk financing instruments**

- Deepen the understanding of the government's liabilities to estimate how much additional \$ could be required; and build a range of financing instruments that are proportionate to the needs, limiting the more costly budget reallocations.

# Thank you



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