



Macroeconomics, Trade & Investment

MTI Practice Notes

The Impact of COVID-19 on Formal Firms: Evidence from Albania

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SUMMARY

This note uses administrative tax data on firms to measure the direct impact of the lockdown on firms' profitability, employment and exit rates. It separates the economy in three sectors, which face different size shocks and considers two lockdown scenarios: one lasting three months and one lasting five months. The five-month scenario is equivalent to a three-month initial lockdown and a later re-introduction of a two-month lockdown, or a longer partial lockdown. The simulations estimate losses to corporate income tax revenue, increases in firms' debt levels, cuts in payroll and their mitigation through wage subsidies, and aggregate output losses from firms' exit.

Overall, the impact on the economy is severe, with large falls in tax revenue, increases in debt and loss of employment. Under a three-month lockdown, we estimate that 61% of firms remain profitable and that more than 86% of firms in the highly-impacted sectors register losses. The corporate income tax revenue loss is severe and

in 2020 would only collect 65% of its baseline. In addition, firms accumulate losses equivalent to 1.6% of GDP, suggesting that firms will need to substantially increase borrowing to survive. Firms would cut 3.9% of total yearly payroll - wage subsidies can save a substantial share of payroll in the medium-impact sector, but will not be able to save employment in the high-impact sector (tourism, transport, personal services), where firms can't pay their fixed costs.

This note faces important limitations: (i) it does not include the indirect impacts of the shocks which operate through firms' trade linkages, (ii) it only models a demand shock and as such firms have no issues obtaining inputs (materials, labor), (iii) Firms do not adapt to the crisis (for example by changing products, selling online etc.). Given these limitations, the numbers in this report should be considered as plausible lower bounds arising from direct effects, in partial equilibrium. Dynamic general equilibrium models of the economy, with linkages across sectors and firms, are needed to gauge longer term effects.

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LOCKDOWN SIMULATIONS AND CATEGORIZATION OF SECTORS BY IMPACT

The COVID19 (coronavirus) pandemic and associated containment measures are expected to cause far-reaching damage to economies around the world. Firms are suffering from reduced demand due to movement restrictions, from reduced labor supply and from constraints to sourcing material inputs. The breakup of otherwise healthy businesses in response to a temporary shock implies large social costs. Governments are therefore intent on designing emergency policies to keep businesses afloat.

We present simulations using firm-level tax records from Albania, which vary the duration of the lockdown and the relative impact across sectors. In these simulated scenarios, demand shocks induce a loss in revenue which triggers a cut in profitability and possibly cuts in employment or even firm closure. We compare these simulations to a baseline (pre-COVID) situation, which corresponds to the last year of available administrative data. Our analysis relies on a few simple assumptions about the structure of firms' revenue and costs: we assume that firms aim to weather the shock such that they can scale their production capacity back up swiftly at the end of the lockdown. In this stylized world, firms can reduce their material costs proportionally to the drop-in demand, are reluctant to reduce their labor costs as re-contracting is costly and cannot adjust their

fixed costs. Finally, we assume that credit constraints prevent borrowing beyond existing loans used to cover predictable losses (i.e. losses unrelated to the shock).

We classify sectors into three impact categories - high, medium and low – depending on their expected loss in revenue during the shutdown, displayed in Table 1. This classification is based on a country-specific ad hoc assessment by the Ministry of Finance. In the high-impact category are sectors which can't operate at all during the lockdown and lose 100% of their revenue during that period. These include tourism, transportation, non-essential retail and entertainment. In the medium impact categories are sectors which operate at half capacity and lose 50% of their revenue. These include manufacturing and education. Finally, the low impact sector only loses 20% of its monthly revenue, in sectors such as essential retail, health, construction and agriculture. Naturally there is still a fair degree of heterogeneity of exposure within the categories, with some subsectors experiencing increased revenue. Table 2 shows the number of firms and economic weight of each of the three impact sectors: the high-impact sector contains 13% of the firms and 6% of the wage bill, the medium impact sector contains 28% of the firms and 37% of the wage bill, and the low-impact sector the remaining 59% of the firms and 57% of the wage bill.

Table 1: Sector Categories and Shocks

Categories	Sectors (e.g., detailed list of sectors in Appendix Table 5)	Expected Monthly Revenue Loss
High Impact	Accommodation and Food Service Activities, Transportation and Non-essential retail, and other highly affected sectors	100%
Medium Impact	Manufacturing Activities, Education and other moderately affected sectors	50%
Low Impact	Essential Retail, Human Health and Social Work activities and other mildly affected sectors	20%

Table 2: Statistics for High, Medium and Low Impact Sectors

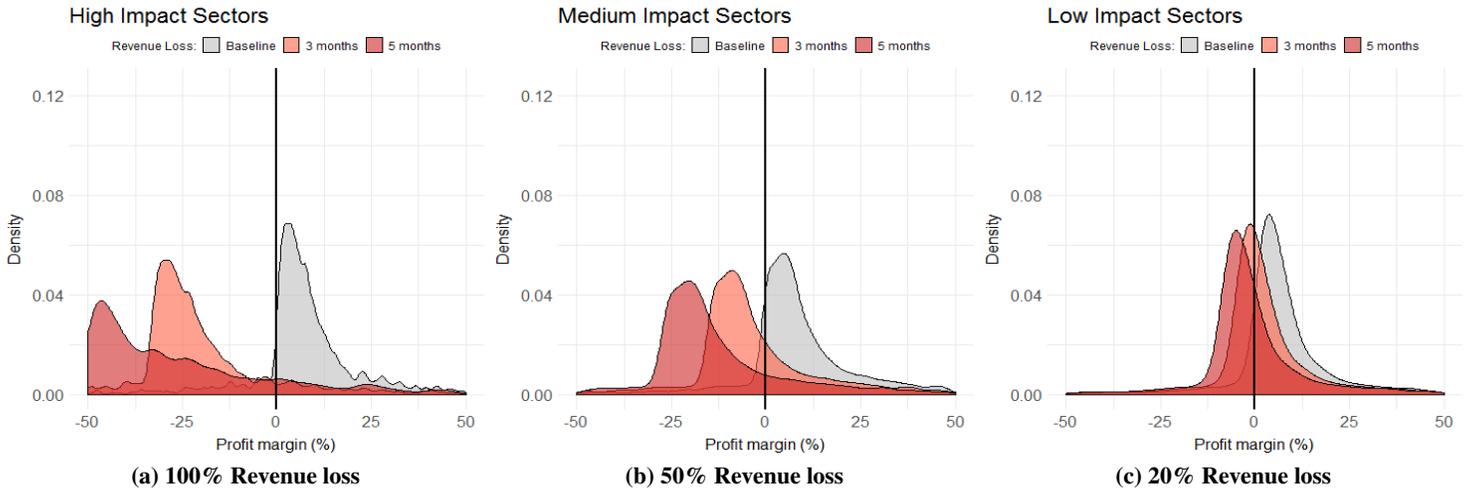
Categories	Aggregates				Averages				
	Number of firms	Share of firms	Revenue share	Wage bill share	Avg. size (LCU, in millions)	Avg. Profit margin	Labor costs (% Total cost)	Material costs (% Total cost)	Fixed costs (% Total cost)
High impact	2440	13%	5%	6%	51	10%	26%	53%	21%
Medium impact	5180	28%	31%	37%	135	12%	26%	45%	29%
Low impact	11165	59%	64%	57%	130	12%	23%	57%	19%

EFFECT ON FIRMS' PROFITABILITY

In this section, we ask what share of firms would need government support to "stay afloat" under a three-month and a five-month lockdown scenario. Assuming credit constraints, a rough indication for firms' ability to stay afloat is a non-negative profit rate. We start by simulating scenarios where firms lose a share of their revenue, while all costs remain constant. The results are displayed

in Figure 1, and show that in the high and medium impact sectors the vast majority of firms becomes unprofitable even under the three-month lockdown scenario. In our simulations, as we use annual data, the five-month lockdown scenario could represent either a continued lockdown lasting five months or a shorter lockdown (e.g. three months) combined with the re-imposition of a lockdown later in the year (e.g. for two months) or a partial continuation of lockdown (e.g. a 50% lockdown for four months).

Figure 1: Firm Profitability Under a Shock to Revenue, No Adjustment to Costs

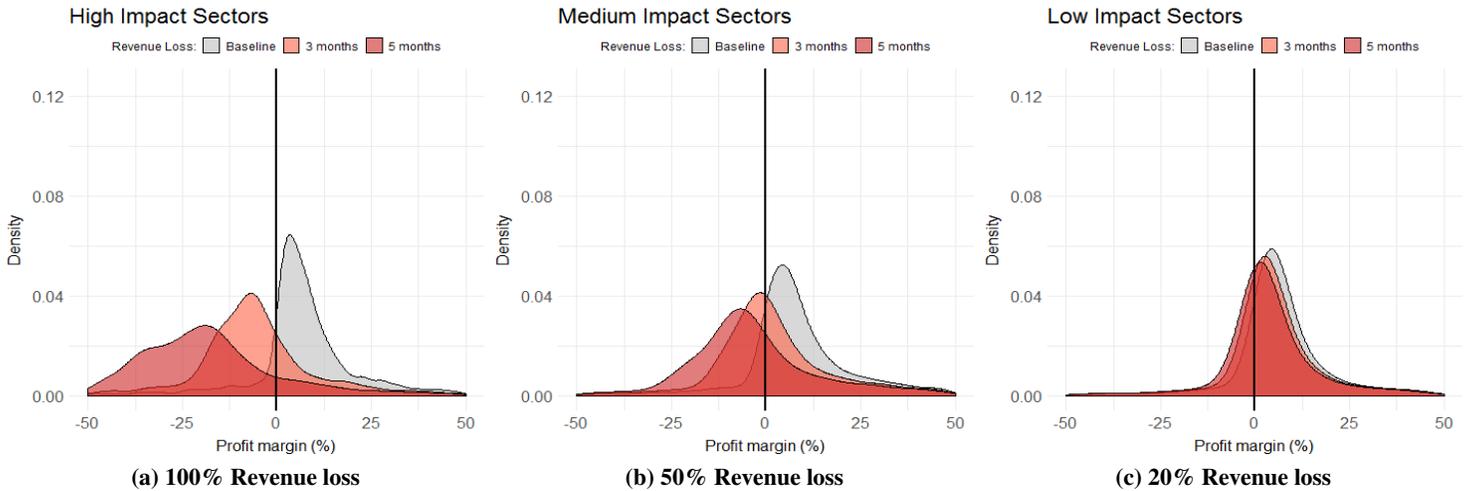


Note: These figures show the distribution of profitability, at baseline, and assuming that firms face a loss in revenue corresponding to either three or five months of loss in yearly revenue. They show the distributions holding all costs constant.

In addition to a pure revenue shock, we simulate a more realistic scenario where firms adjust their material costs proportionally to their revenue loss. The results are displayed in Figure 2: 86.2% of firms in the high-impact sector are profitable at baseline, a number which drops to 26.3% for the three-month lockdown scenario and to 13.7% under a five-month lockdown. The impact is less severe in the medium and low impact sectors, since the shock they face is less severe and since these sectors rely more heavily on material

inputs than the high impact sector. On aggregate, 61% (50%) of all firms remain profitable under a three-month (five-month) lockdown. We also observe that the distribution becomes slightly multi-modal for high impact firms: while firms using mainly material inputs and little labor or capital inputs can adjust to some extent and limit their losses, firms with a small share of material inputs in total cost have little margin to adjust and suffer much larger losses.

Figure 2: Firm Profitability Under a Shock to Revenue, Material Costs Adjust in Proportion

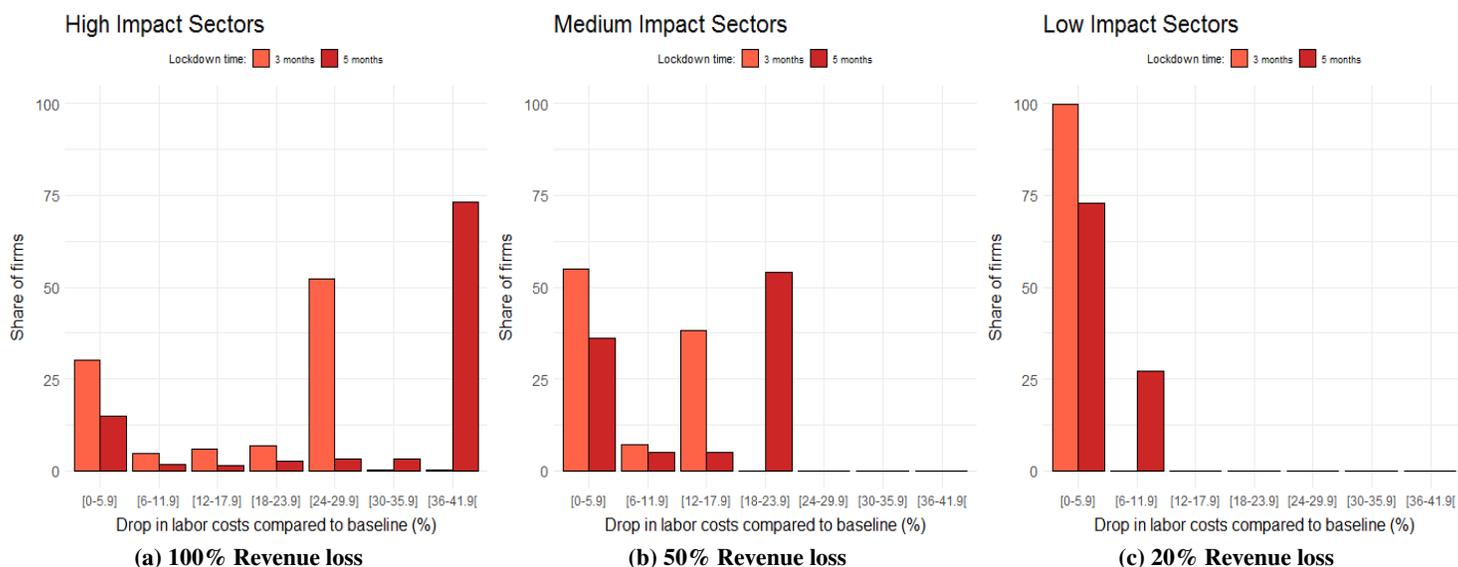


EFFECT ON EMPLOYMENT AND SIMULATIONS OF WAGE SUBSIDIES

In this section, we study by how much employers would need to slash their yearly wage bill in the absence of government support. We continue to assume that material inputs adjust first, and that firms only cut their wage bill if they are still unprofitable after the material inputs adjustment. Figure 3 shows the resulting distributions of the reduction in the yearly wage bill for a three or five month lockdown scenario. The figure is bi-modal: the first spike corresponds to firms which are sufficiently profitable at baseline: they absorb the shock and keep paying their workers. The second spike

corresponds to firms which have to cut their wage bill proportionally to the shock in an attempt to stay afloat. In the middle of the distribution, a share of firms reduces their wage bill somewhat (but less than proportionally to the shock) and achieves zero profit (or retains to pre-shock projected losses): providing even modest wage subsidies to these firms has the potential to save jobs. On aggregate, weighting by firms' yearly wage bill, this would lead to a cut in payroll of 3.9% (resp. 8.5%) of the formal economy's total yearly wage bill in the three-month lockdown (resp. five-month). The payroll loss is of course concentrated in the high-impact sectors which would cut 15.9% (resp. 33.2%) of payroll under the three-month lockdown (resp. five-month).

Figure 3: Wage Bill Reduction from a Revenue Shock, Material Costs Adjust Proportionally



Key Fiscal Policy Responses to COVID-19, as of May 21, 2020:^a

1. Package adopted on March 19th (1.4% of GDP):

- Additional funding for health sector
- Support of small businesses/self-employed forced to close activities by paying them minimum salaries
- Defense spending reallocated toward humanitarian relief for the most vulnerable
- Sovereign guarantee fund for companies to access overdrafts in the banking system to pay wages for their employees for up to three months with an interest rate capped

2. Package adopted on April 15th (1.3% of GDP):

- Fund to pay for a one-off transfer to employees of small businesses affected by the pandemic not covered in the first package, employees of large businesses laid off, and employees in the tourism sector
- Sovereign guarantee to provide loans for working capital for all private companies that were tax-compliant and solvent before the pandemic
- Tax deferral measures allowing certain companies to defer payment of profit tax until after September. Tourism, active processing and call centers, and small businesses can defer payments of profit tax to next year.

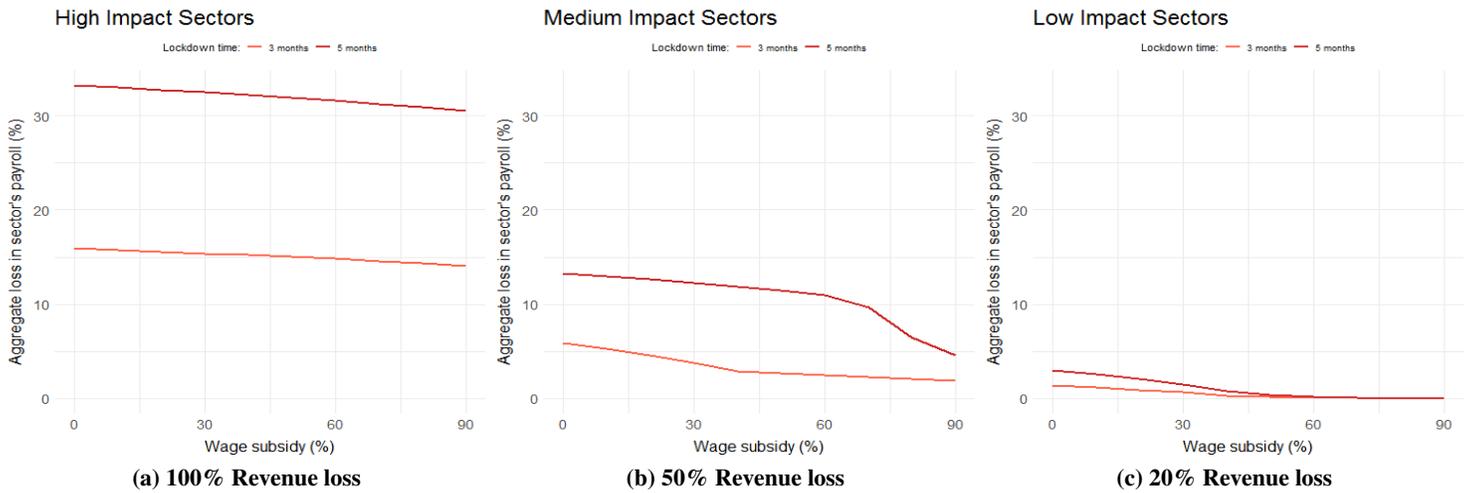
^aSource and more details can be found on the [IMF Policy Responses to COVID-19](#) page

WAGE SUBSIDY SIZE AND EMPLOYMENT EFFECTS

To counteract these payroll losses and destruction of jobs, the government might consider offering wage subsidies to firms, in order to protect formal employment. Figure 4 shows each sector’s aggregate payroll losses when varying the size of the wage subsidy, measured as the share of firms’ payroll paid by the government. In the case of a zero-wage subsidy the loss in payroll corresponds to the

numbers mentioned above. As the wage subsidy increases the loss in payroll decreases, as some firms now return to zero profits (or to their baseline losses). The impact on payroll loss is however very different across the three impact sectors: On the one hand, for the high impact sectors (Figure 3a), the loss in revenue is too severe to be compensated by wage subsidies and these firms are forced to cut employment, even for large wage subsidies.

Figure 4: Aggregate Sector Loss in Payroll as a function of the Size of the Wage Subsidy



Note: These figures show to what extent a government wage subsidy for the retained labor force can absorb the aggregate loss in payroll, if the lockdown lasts three or five months. Firms readjust their decision after receiving a wage subsidy: they first adjust their material costs, and then their wage bill. We still assumed that firms keep paying wages as long as they remain profitable.

To understand this, note that we assume that these firms still have to pay their fixed costs (e.g. rent) and a reduction in labor costs is not sufficient to counteract the revenue loss. On the other hand, wage subsidies can save payroll for the low, and especially the medium-impact sector: in the latter sector, a 60% wage subsidy over the lockdown period would roughly halve the sector’s payroll loss. On aggregate, applying a 50% wage subsidy across all sectors would reduce the yearly payroll loss from 3.9% to 2.0% (three-month lockdown) or from 8.5% to 6.3% (five-month lockdown). It would take a substantial subsidy to save more payrolls: even with a 90% wage subsidy the loss in yearly payroll would be reduced only to 1.5% (three-month lockdown) or to 3.5% (five-month lockdown).

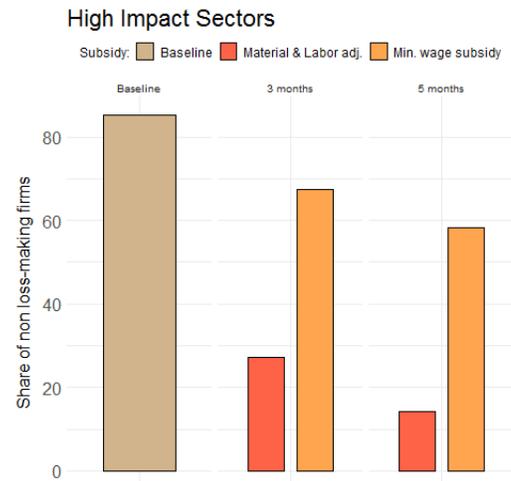
WAGE SUBSIDIES AS IMPLEMENTED AND IMPACTS ON PROFITABILITY AND EMPLOYMENT

The Government of Albania has adopted a large multi-faced package of measures to counter the impact of COVID19 on formal firms and offers wage subsidies for key sectors. Among other measures (see Key Fiscal Policy Responses to COVID-19), firms which have to shut down (i.e. high impact sector firms) benefit from a subsidy of 100% of the gross minimum wage for all employees. We do not observe the number of workers of each firm, but its total payroll has been imputed by using the cost structure of other countries: to make progress, we assume that each firm pays its workers the average wage in the economy.² We continue to assume that firms adjust their costs in reaction to the subsidy as above. We set the subsidy to 100% of the gross minimum wage,³ per month and per worker, for the high impact sectors, which roughly corresponds to a 50% subsidy of the full payroll.

As previously shown in figure 4, the subsidies offered in practice might not be enough to curtail short term payroll losses significantly in the high impact sector, although they have more of an effect on the medium impact sector. However, they might be able to bring a non-negligible set of firms back to non-loss making territory, which could allow them to survive the lockdown and restart operations thereafter.

Figure 5 shows that the wage subsidies will push an additional 40 percentage points of the high impact sector firms into non-loss making territory. In the five month lockdown scenario, the share of high impact firms which are not loss making would jump from under 17% without the wage subsidies, to almost 60% with the subsidies.

Figure 5: Firms’ Profitability with and without the Government Wage Subsidies



Note: This figure show the share of non-loss making firms after a 3 or 5 month lockdown, with or without the wage subsidy implemented by the Government of Albania. Loss making firms include firms with zero profits.

FIRMS’ EXIT RATES INDUCED BY THE REVENUE SHOCK

Here we predict the increase in firms’ exit under the different lockdown scenarios. We use the panel dimension of the data to measure the excess exit rate in pre-crisis years separately for negative and positive profit firms (and in each of the three impact sectors). Figure 6 (a) shows these exit rates in regular times: on average 12% of firms exit in any given year; however firms which had losses in

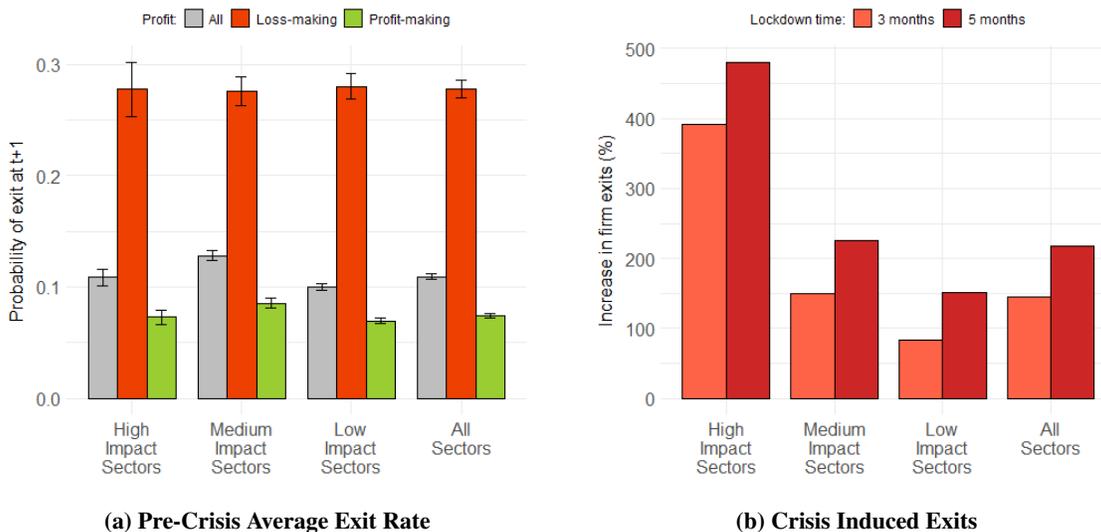
²We use the Average labour costs per employee in full time units by economic activity provided by the Albanian Statistical Institute.

³In 2019, the gross minimum wage equals EUR210.66 (Lek 26,000).

the previous year have an exit rate which is at least 20% higher than firms which had positive profits. In our previous analysis, we estimated the share of firms which have negative profits due to the crisis, for each impact sector. We thus combine these results to measure the percentage increase in exits induced by the crisis, by multiplying the share of newly loss-making firms with their excess exit rate. We

show the results for the three and five-month lockdown scenario in 6 (b): under a three (five)-month lockdown scenario, firms' exits from the formal economy increase by 145% (218%). This loss of firms is of course particularly acute for the high impact sector where the percentage increase in firms' exits is 392% (480%) compared to the average pre-crisis year.

Figure 6: Firms' Exit Rate



Note: Panel (a) shows the average exit probability for all firms, and then for loss-making and profit-making firms, using panel data before the crisis. Panel (b) shows the percentage increase of firms' exit induced by a 3 or 5 month output loss, compared to baseline levels.

AGGREGATE NUMBERS AND IMPACTS ON THE ECONOMY

The impact on the overall economy is severe, with large falls in tax revenue, increases in debt and loss of employment. Table 3 summarizes the key numbers for the three and five-month lockdown scenarios and the aggregate impact on the economy. 61% or less of firms remain profitable after the shock, and almost all firms in the highly impacted sectors register losses. The Corporate Income Tax revenue loss is severe, reaching 34% overall in the three-month shock scenario and 49% in the five-month shock scenario. In the high-impact sectors, almost all CIT revenue is lost. This is because, despite the temporary nature of the shock, the shock generates large losses which are counted against the profits made during the remainder of the year. The absolute increase in losses is 1.6% (3.8%) with

the three-month shock [five-month shock], suggesting that firms will need to substantially increase borrowing. Payroll losses are also substantial, ranging between 3.9% and 8.5% of the annual wage bill - wage subsidies can safeguard some employment, especially in the medium-impact sectors: a 50% wage subsidy would reduce the payroll losses from 3.9 to 12.0% (8.5% to 6.3%) in the three (five) month lockdown scenario. Increases in firm exit are relatively small, meaning that associated output and payroll losses are also small, but this is likely an under-estimate: Our panel data features only a smaller number of firms that experience large revenue losses and hence allow us to estimate the effect, presumably because most such firms exit the panel. Our estimates mean that the size of government rescue packages for firms and workers needs to be large, and the budget support from donors to lower-income countries even larger, to compensate for the massive loss in tax revenue.

Table 3: Aggregate Impacts by Lockdown Duration and by Impact sectors

		High Impact		Medium Impact		Low Impact		All Sectors		
		3 months	5 months	3 months	5 months	3 months	5 months	3 months	5 months	
1	Share of firms profitable at baseline	86.2%		85.8%		87.4%		86.8%		
2	Share of firms still profitable (material adj.)	26.3%	13.7%	48.0%	32.4%	74.9%	65.3%	61.2%	49.5%	
3	CIT revenue loss relative to baseline (%)	66.4%	84.8%	45.8%	61.8%	22.0%	34.1%	34.4%	48.5%	
4	Absolute losses increase (% GDP)	0.4%	0.9%	0.8%	2.1%	0.3%	0.7%	1.6%	3.8%	
	No wage subsidy	15.9%	33.2%	5.8%	13.2%	1.4%	2.9%	3.9%	8.5%	
5	Payroll Loss	50% wage subsidy	15.0%	31.9%	2.7%	11.4%	0.2%	0.4%	2.0%	6.3%
		90% wage subsidy	14.1%	30.5%	1.9%	4.6%	0.0%	0.0%	1.5%	3.5%
6	Percentage increase in exit relative to baseline	392.2%	480.3%	149.5%	225.0%	83.7%	150.7%	145.3%	218.0%	
7	Permanent output loss from firm exit (% GDP)	0.2%	0.3%	0.7%	1.1%	0.4%	0.8%	1.4%	2.1%	
8	Permanent payroll loss from firm exit (% GDP)	1.4%	1.7%	4.0%	6.1%	3.1%	5.7%	8.5%	13.4%	

Table 4: Absolute losses, in Million Lek, by Lockdown Duration and by Impact sectors⁴

		High Impact		Medium Impact		Low Impact		All Sectors	
		3 months	5 months	3 months	5 months	3 months	5 months	3 months	5 months
CIT revenue loss		1,163	1,485	5,487	7,406	3,402	5,270	10,052	14,161
Additional losses		6,299	13,520	12,244	32,001	5,083	11,138	23,626	56,659
	No wage subsidy	3,271	6,824	7,445	16,890	2,732	5,855	13,447	29,569
Payroll Loss	50% wage subsidy	3,088	6,560	3,439	14,564	333	819	6,861	21,944
	90% wage subsidy	2,896	6,269	2,433	5,873	1	1	5,330	12,144
Permanent output loss (Billion Lek)		331	405	1,085	1,633	634	1,142	2,050	3,180
Permanent payroll loss (Billion Lek)		2,037	2,494	6,079	9,148	4,733	8,525	12,849	20,167

⁴Nominal figures are adjusted for 2020 inflation (forecast inflation rate is 2.39% for 2019-2020, according to The World Economic Outlook (WEO)).

Table 5: Sectors and Impact Categories

SECTORS (ISIC Rev 4 code)	High - Medium - Low Impact	
A AGRICULTURE, FORESTRY AND FISHING	Low Impact	
B MINING AND QUARRYING	Low Impact	
C MANUFACTURING	Low Impact	Medium Impact
	Food products; Beverages; Tobacco products; Basic pharmaceutical products and pharmaceutical preparations	Textiles; Wearing apparel; Leather and related products; Wood and of products of wood and cork, except furniture; manufacture of articles of straw and plaiting materials; Paper and paper products; Printing and reproduction of recorded media; Coke and refined petroleum products; Chemicals and chemical products; Rubber and plastic products; Other non-metallic mineral products; Basic metals; Fabricated metal products, except machinery and equipment; Computer, electronic and optical products; Electrical equipment; Manufacture of machinery and equipment n.e.c.; Motor vehicles, trailers and semi-trailers; Other transport equipment; Furniture; Other manufacturing; Repair and installation of machinery and equipment
D ELECTRICITY, GAS, STEAM AND AIR CONDITIONING SUPPLY	Medium Impact	
E WATER SUPPLY; SEWERAGE, WASTE MANAGEMENT AND REMEDIATION ACTIVITIES	Medium Impact	
F CONSTRUCTION	Medium Impact	

G WHOLESALE AND RETAIL TRADE other than food, pharmacies, gas stations	High Impact	Low Impact
	Automobile Dealers; Other Motor Vehicle Dealers; Furniture Stores; Home Furnishings Stores; Clothing Stores; Shoe Stores; Jewelry, Luggage, and Leather Goods Stores; Sporting Goods, Hobby, and Musical Instrument Stores; Book Stores and News Dealers; Department Stores; Florists; Office Supplies, Stationery, and Gift Stores; Other Miscellaneous Store Retailers; Consumer Goods Rental; General Rental Centers; Apparel, Piece Goods, and Notions Merchant Wholesalers; Automotive Parts, Accessories, and Tire Stores; Direct Selling Establishments	Remaining sub-categories
H TRANSPORTATION AND STORAGE	High Impact	Medium Impact
	Scheduled Air Transportation; Nonscheduled Air Transportation; Taxi and Limousine Service; School and Employee Bus Transportation; Other Transit and Ground Passenger Transportation; Support Activities for Air Transportation; Support Activities for Water Transportation; Traveler Accommodation	
I ACCOMMODATION AND FOOD SERVICE ACTIVITIES	High Impact	Medium Impact
	Special Food Services; Drinking Places (Alcoholic Beverages); Restaurants and Other Eating Places	Remaining sub-categories

J INFORMATION AND COMMUNICATION	Low Impact	
K FINANCIAL AND INSURANCE ACTIVITIES	Medium Impact	
L REAL ESTATE ACTIVITIES	Medium Impact	
M PROFESSIONAL, SCIENTIFIC AND TECHNICAL ACTIVITIES	Low Impact	
N ADMINISTRATIVE AND SUPPORT SERVICE ACTIVITIES	Low Impact	
O PUBLIC ADMINISTRATION AND DEFENCE; COMPULSORY SOCIAL SECURITY	Low Impact	
P EDUCATION	Medium Impact	
Q HUMAN HEALTH AND SOCIAL WORK ACTIVITIES	Low Impact	
R ARTS, ENTERTAINMENT AND RECREATION	High Impact	Medium Impact
	Performing Arts Companies; Spectator Sports; Independent Artists, Writers, and Performers; Amusement Parks and Arcades; Gambling Industries; Other Amusement and Recreation Industries	Remaining sub-categories
S OTHER SERVICE ACTIVITIES	High Impact	Medium Impact
	Offices of Dentists; Personal Care Services; Other Personal Services	Remaining sub-categories

CALCULATION DETAILS FOR TABLE 3

Each figure is calculated for a specific Impact category (High, Medium, Low impact and All sectors) and for a specific lockdown scenario (three and five months):

1. Share of firms profitable at baseline: (1) number of firms with positive profit margin before output shock, divided by (2) total number of firms, expressed as percentage.
2. Share of firms still profitable (material adj.): (1) number of firms with positive profit margin, after material costs adjustment proportional to the shock, divided by (2) total number of firms, expressed as percentage.
3. CIT revenue loss relative to baseline: (1) sum of all firms' profits at baseline multiplied by the corporate income tax rate minus (2) sum of all firms' profits after lockdown multiplied by the corporate income tax rate, divided by (1) and expressed as percentage.
4. Absolute losses increase (% GDP): (1) absolute value of the sum of all firms' losses after lockdown minus (2) absolute value of the sum of all firms' losses at baseline, divided by (3) GDP (current LCU of the same year), expressed as percentage.
5. Payroll Loss, at different wage subsidy rate: (1) sum of all firms' new labor costs under lockdown, divided by (2) the sum of all firms' labor costs at baseline, expressed as percentage.
6. Percentage increase in exit rate relative to baseline: (1) exit rate of firms after lockdown minus (2) exit rate of firms at baseline, divided by (2) and expressed as percentage.
7. Permanent output loss from firm exit (% GDP): (1) additional exit rate relative to baseline multiplied by (2) the sum of all firms' turnover at baseline, divided by (3) GDP (current LCU of the same year), expressed as percentage.
8. Permanent payroll loss from firm exit (% GDP): (1) additional exit rate relative to baseline multiplied by (2) the sum of all firms' labor costs at baseline, divided by (3) GDP (current LCU of the same year), expressed as percentage.