



MACROECONOMICS,  
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## EQUITABLE GROWTH, FINANCE & INSTITUTIONS INSIGHT

# An Overview of Potential Impact of COVID-19 Crisis on the Accumu- lation of Government Expenditure Arrears

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# ABSTRACT

The COVID-19 pandemic introduced tremendous fiscal pressures for many countries, requiring additional spending to mitigate the health, economic, and social impacts of the pandemic while government revenues are falling.

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*Governments are addressing these fiscal pressures through a range of measures, including additional borrowing and expenditure adjustments. In environments where fiscal space is tight and public expenditure management is weak, the accumulation of government expenditure arrears is likely. This note presents some early data on the impact of these fiscal pressures on government arrears in low income countries.*

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# 3





# An Overview of Potential Impact of COVID-19 Crisis on the Accumulation of Government Expenditure Arrears

## >> INTRODUCTION

The COVID-19 pandemic introduced tremendous fiscal pressures for many countries, requiring additional spending to mitigate the health, economic, and social impacts of the pandemic while government revenues are falling. Governments are addressing these fiscal pressures through a range of measures, including additional borrowing and expenditure adjustments. In environments where fiscal space is tight and public expenditure management is weak, the accumulation of government expenditure arrears is likely. This note presents some early data on the impact of these fiscal pressures on government arrears in low income countries. Before presenting the data, we discuss briefly definition and measurement of arrears as well as the main drivers and economic consequences of arrears accumulation. We conclude with some options for preventing and managing arrears accumulation.

## >> DEFINITION AND MEASUREMENT

Government expenditure arrears are financial obligations that have been incurred by any level of the public sector for which payments have not been made by the due date (Flynn and Pessoa, 2014). Contractually agreed interest and penalties on overdue payments also form part of arrears. Arrears can be classified by the underlying type of expenditure and whether they are within the public sector - including payments for goods and services provided by public utilities and other SOEs as well as transfers and subsidies to subnational governments, SOEs, statutory funds and other government entities - and arrears with individuals and entities outside government - including wages and salaries, payments to commercial contractors and suppliers, interest and principal on government debt and other liabilities, and transfers and subsidies to households, and businesses.

There is wide variation across countries and types of payment obligations as to when these turn into arrears and whether and when they are registered and reported. Weaknesses in governments' PFM systems hinder the adequate capture and timely reporting of domestic arrears, a problem likely compounded by work-from-home policies enacted since the outbreak of the COVID-19 pandemic. The lack of standardized national definitions and coverage further

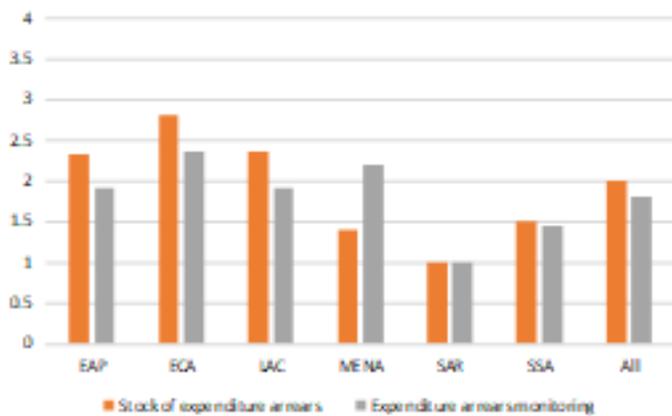
complicates the problem of quantifying arrears across countries (IMF 2019). Figures on arrears, where they exist, are often incomplete due to “unrecognized” arrears, i.e., arrears that have not yet been recorded or audited, often including arrears to utilities and social security funds. Due payments to suppliers may not turn as quickly and as visibly into arrears as obligations for debt service, wages and salaries, potentially remaining unrecognized for some time. Terms of payment often include long and sometimes flexible payment deadlines, invoices may not be recorded on a timely basis in governments’ PFM systems, and payment terms are often re-negotiated with suppliers.

“Arrears” to SOEs and transfers to subnational governments are often not recorded as arrears and used extensively in moving around fund flows in the interest of reaching a fiscal deficit target. For the SOEs, public institutions do not pay for the services delivered; SOEs do not pay their taxes, or submit dividends, and often governments are “bailing them out” on a regular basis. While cross arrears are frequent for “within public sector arrears,” they also occur with respect to entities outside government, especially in the form of tax arrears and generate complex financial management and transparency issues for all parties involved.

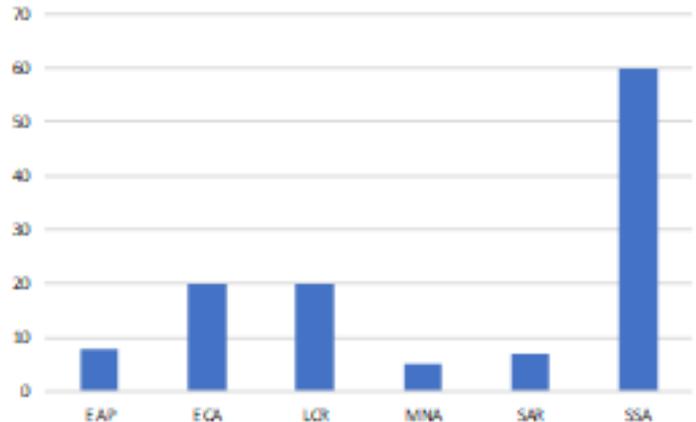
The way arrears are reflected in a country’s public financial accounts differs depending on whether cash or accrual accounting is being used. With cash accounting, only actual payments received and made are reflected in the accounts. Consequently, the accumulation of arrears during a fiscal year would make that year’s fiscal deficit appear smaller as payment is delayed to another fiscal year. Therefore, under cash accounting, arrears can affect the size of the fiscal deficit and authorities at times use arrears to achieve fiscal targets. Under accrual accounting, on the other hand, revenue is recorded when earned and expenditures when incurred and the size of the fiscal deficit would not be affected by the accrual of arrears.

Public Expenditure and Financial Accountability Assessments (PEFAs) for 76 countries suggest that arrears are widespread and monitoring of arrears often weak (Figure 1). Countries in the South Asia and Africa regions have the highest levels of arrears and the weakest monitoring systems, while countries in ECA have relatively strong monitoring systems and low levels of arrears.

>>> **FIGURE 1 - PEFA Arrears Indicators by Region**

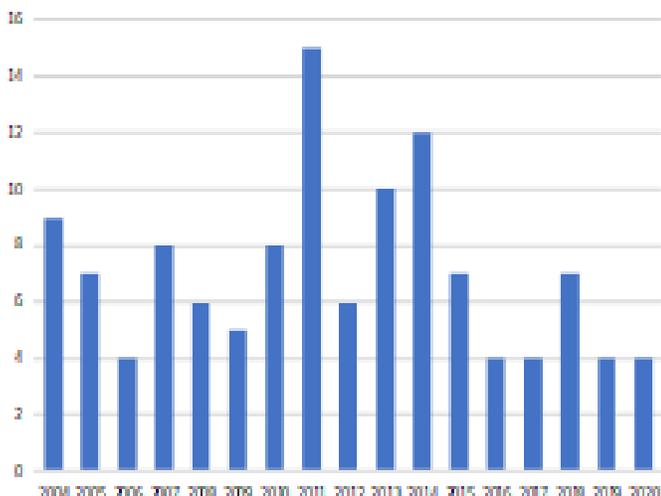


>>> **FIGURE 2 - Arrears-related DPO Prior Actions by Region, FY2000-20**



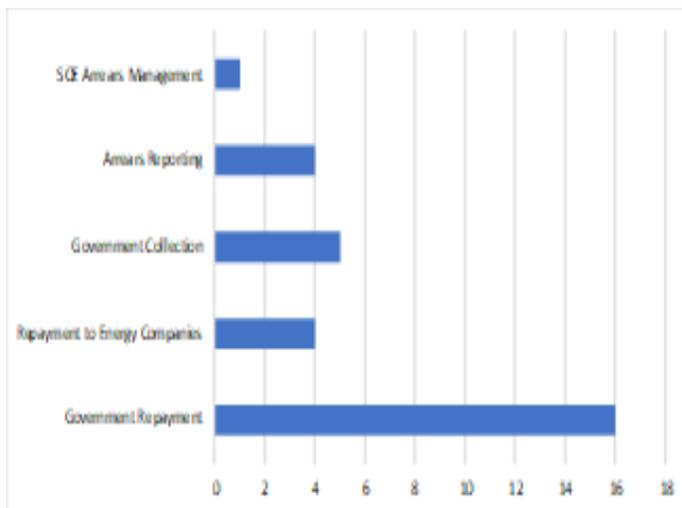
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**FIGURE 3 - Arrears-related DPO Prior Action by Approval Year, FY2004-20 (#)**



> > >

**FIGURE 4 - Arrears-related DPO Prior Actions by Theme, FY2015-20 (#)**



Note: With respect to the stock of arrears, PEFA ratings of 2/3/4 (corresponding to the original rating of C/B/A) indicate that the stock of expenditure arrears is no more than 10%/6%/2% of total expenditure in at least two of the last three completed fiscal years. With respect to expenditure arrears monitoring, PEFA ratings of 2/3/4 indicate that data on the stock and composition of expenditure arrears is generated: annually at the end of each fiscal year / quarterly within eight weeks of the end of each quarter / quarterly within four weeks of the end of each quarter. For both sub-indicators, a rating of 1 (D) indicates that performance is less than required for a score of 2.

Widespread problems with arrears are also reflected in the World Bank’s Development Policy Operations, which often support countries in reducing arrears and strengthening PFM systems to prevent and manage arrears. In the past five years, 30 prior actions in the World Bank’s development policy operations supported programs to address arrears problems. About half of these actions targeted directly arrears clearance. Payment of arrears to energy companies, collection of arrears to government, and strengthening arrears reporting are also supported in several DPOs (Figure 4). Looking at arrears-related prior actions in DPOs over the past 15 years (Figure 3) shows an increase in their frequency in the years following the global financial crisis, hinting at the impact of the crisis on arrears. Over that period, arrears related prior actions were most frequent in the Africa region (60 prior actions), but DPOs in ECA and LAC also addressed arrears issues frequently (20 prior actions in each region) (Figure 2).

A recent IMF study (2019) on domestic expenditure arrears in Sub-Saharan Africa<sup>1</sup> showed that they significantly increased since the global financial crisis, especially in commodity exporting countries, in parallel with the increase in public and private debt. As a result, arrears were already large and pervasive vis-à-vis historical trends before the onset of the COVID-19 pandemic, adding to existing vulnerabilities of limited fiscal space. The 2019 IMF report also showed that at least 70 percent of countries in Sub-Saharan Africa had domestic expenditure arrears in 2018 amounting on average to about 3% of GDP with arrears to private sector suppliers accounting for the largest share, followed by arrears to SOEs; government employees; statutory funds; and subnational governments.

1. Sub-Saharan Africa Regional Economic Outlook: Navigating Uncertainty, IMF, October 2019.

## >> DRIVERS OF ARREARS ACCUMULATION

Government arrears are in the first instance the consequence of weaknesses in public expenditure systems that fail to align and constrain expenditures to available resources. These include the adoption of policy initiatives without proper costing and identification of funding sources, government budgets that are based on unrealistic revenue estimates and underestimate expenditure; weak commitment control and cash management at the budget execution stage; and often also simple weaknesses in the management and processing of payables, compounded in some cases by illegal and corrupt practices such as illegitimate or inflated invoices and corrupt processes for the settlement of invoices. All these factors result in a situation where accounts payable are not settled on time. “Within public sector” arrears are also used to achieve fiscal deficit targets.

Fiscal shocks such as unforeseen expenditure requirements and drops in government revenue as in the case of natural disasters or pandemic outbreaks can create extraordinary fiscal pressures leading to arrears even in environments where public expenditure management is solid enough to prevent the accumulation of persistent and large arrears in normal times. Indeed, large fiscal shocks are historically a leading indicator of substantial arrears accumulation, especially where PFM systems are weak. The IMF (2019) estimated that for Sub-Saharan African economies, a one-standard deviation decline in GDP growth and in commodity terms of trade would result in a 0.9 and 0.6 percentage point increase in the domestic expenditure arrears-to-GDP ratio, respectively. Naturally, these effects would generally be larger in countries with weak fiscal institutions and PFM systems as well as other macroeconomic and structural factors such as fixed exchange rates regimes, limited fiscal space, and countries in fragile situations.

## >> CONSEQUENCES OF ARREARS ACCUMULATION

Government arrears have a corrosive effect on public finances and economies. Delayed, or non-payment of obligations, has direct effects on those due to receive payment, with potential spill-over effects reverberating throughout the economy. Such impacts are particularly severe in an environment of economic crisis and recession, where private sector revenue streams are also under stress and where expected incomes and payments from government are often critical to avoiding hardship for households and avoiding liquidity and solvency problems for businesses, SOEs, and other government entities. These, in turn, may affect entire value chains, as those suffering delayed or non-payment from the government may not be able to fulfill their commitments to their employees, to their suppliers, to their creditors, to their owners and even to the same government.

To the extent that government arrears are a recurring problem, they will also affect the cost and quality of government procurement. Suppliers will factor in the likelihood of government payment difficulties into the pricing of goods and services and their decisions to enter into contracts with governments. High quality suppliers may decide to refrain from government engagements. In general, delayed or non-payment of arrears will undermine the credibility of government with not only the entities with whom it transacts, but also with the financial sector and citizens more widely. Loss of credibility with the public and the financial sector is of

particular consequence, as it may result in reduced access to credit and reduced tax morale and compliance.

Arrears can also create complex governance issues, as they introduce a significant degree of administrative discretion into public financial management both at the time when they are created and when they are settled. In an environment where there is not enough money available to settle all payments before their due dates, public finance managers decide which obligations to settle before their due date and which not. Similarly, once the authorities embark on settling arrears, there are typically again decisions to be made on which arrears to give priority. This creates opportunities for corruption, where illegal payments can influence the prioritization of the settlement of particular invoices and arrears. In addition, once governments start to accumulate arrears, there are additional governance risks in terms of illegitimate invoices and high penalties for payment delays that are added to the arrears stock for settlement.

## >> THE IMPACT OF COVID-19 ON ARREARS ACCUMULATION AND SETTLEMENT - EARLY DATA

As the COVID-19 pandemic triggered sharp drops in GDP, government revenues, and commodity prices around the globe, government arrears are likely to increase in many countries. The Global Economic Prospects (June 2020) projects real GDP growth in EMDEs to drop by 6 percentage points to a -2.5 percent in 2020. Using the estimated relationship between a shock to GDP and the increase in arrears for Sub-Saharan Africa, this would imply that domestic expenditure arrears would be expected to increase by more than 2 percent of GDP on average, though countries with weak fiscal institutions and PFM systems – as well as commodity exporters - are at risk of significantly higher accumulation of arrears.<sup>2</sup>

Data and commentary received from WB country economists revealed some important emerging trends with respect to arrears accumulation and arrears stocks in the early months of the COVID-19 pandemic.<sup>3</sup> All country economists were canvassed to obtain information on the evolution of arrears following the outbreak of the Covid-19 pandemic.<sup>4</sup> In all, 74 country responses were received, of which 25 included recent data on arrears, 14 only included basic narrative of recent trends and 35 provided insufficient data and information for inclusion in analysis. Of the 25 countries for which data on arrears was received, about a third registered an increase in arrears since March 2020 (Figure 5). These were mostly concentrated in Sub-Saharan Africa<sup>5</sup> and within domestic debt service arrears. Four countries in Sub-Saharan Africa<sup>6</sup> also presented arrears disaggregated by economic category; within this group, most governments reported to have kept current, or even reduced, their arrears in salaries, social contributions, pensions and transfers.

Data also indicate financial sector dynamics that could increase macro-financial vulnerabilities. For instance, some countries have securitized arrears while others have allowed debt service arrears to increase while simultaneously reducing

arrears in other categories. This may signal that governments are leaning on domestic financial institutions to absorb governments' liquidity pressures, creating space to remain current or reduce obligations on other categories of accounts payable.

With respect to supplier arrears, they have not recorded significant increases in the countries for which data are available. In some countries this reflects a deliberate policy to keep small- and medium-size suppliers afloat and prevent further strain on businesses, unemployment, economic activity, and business confidence<sup>7</sup>. However, as mentioned above, due payments to suppliers may not turn as quickly, and as visibly into arrears as obligations for debt service and wages and salaries, with the potential to remain unrecognized for some time. Therefore, further investigation will be needed to corroborate these trends and assess with precision the exact size of arrears.

Outside of the general government, there is some evidence that arrears to and by SOEs may have increased as a result of the liquidity crunch, although further investigation is warranted. The halt in economic activity has strained the balance sheets and income statements of SOEs, particularly utility and energy corporations. Exacerbating these constraints, some governments that are accustomed to providing direct support to their SOEs now find themselves with limited fiscal capacity to do so. As an example, consolidated comments from the ECA Region reveal that arrears are concentrated in SOEs, especially in the energy, transport, and communications sectors. The drop in oil prices is likely to have reduced financial pressures on the energy utility corporations and oil importing countries in general, but postponement of utility payments as well as lockdowns and slowdown in economic activity are likely to have had a severe negative impact on the financial situation of SOEs.

2. The median of the standard deviation of real GDP growth for all countries over the period 2001-2017 was about 2.7 percent.

3. Data quality considerations might affect the validity of these findings - see Annex 3- Caveats to Data & Analysis.

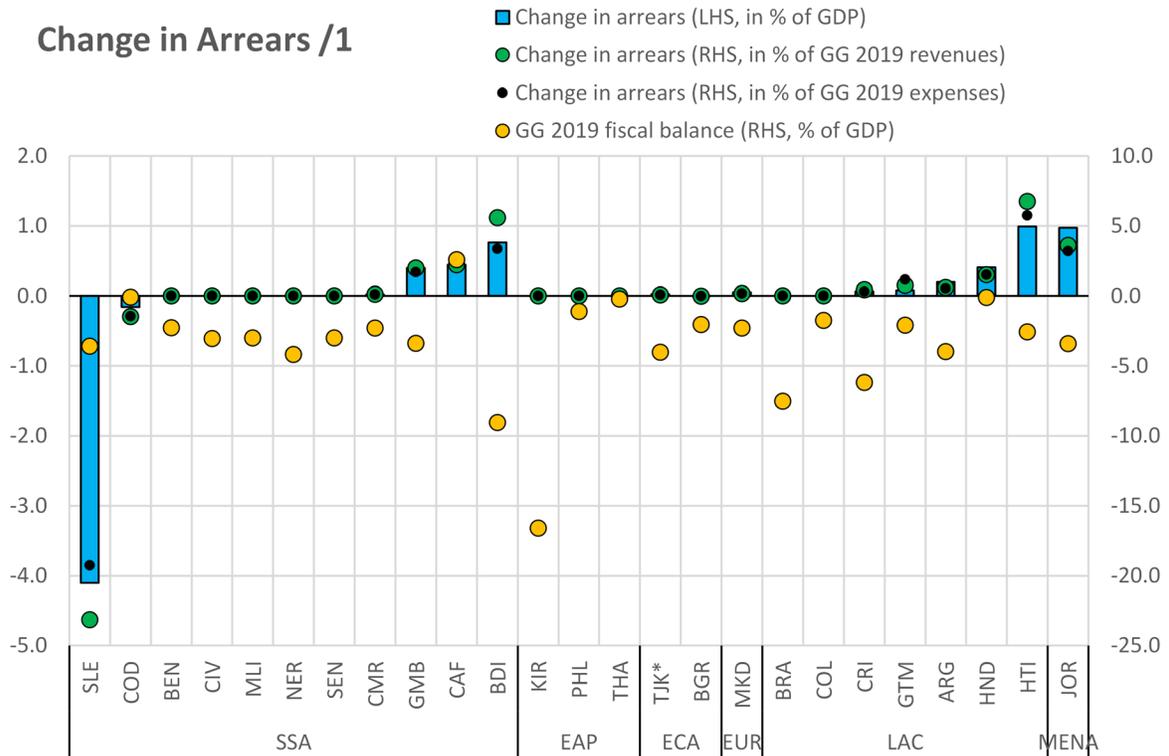
4. The standard definition of domestic expenditure arrears excludes overdue debt service. However, available data at times do not make this distinction and therefore the data in this note also includes domestic debt service arrears.

5. See Annex 1 for a discussion on a country by country basis.

6. SSA countries that have provided disaggregated arrears by category are: Cameroon, Central African Republic, The Democratic Republic of Congo, and Sierra Leone.

7. This was the case for instance in Cameroon, Democratic Republic of Congo, Sierra Leone, Haiti, and Costa Rica where supplier arrears have, in fact, decreased.

**FIGURE 5 - Change in Arrears Following the COVID-19 Outbreak**



/1 Dates for pre and post COVID vary (June-20/Mar-20, June-20/Dec-19, May-20/Mar-20)

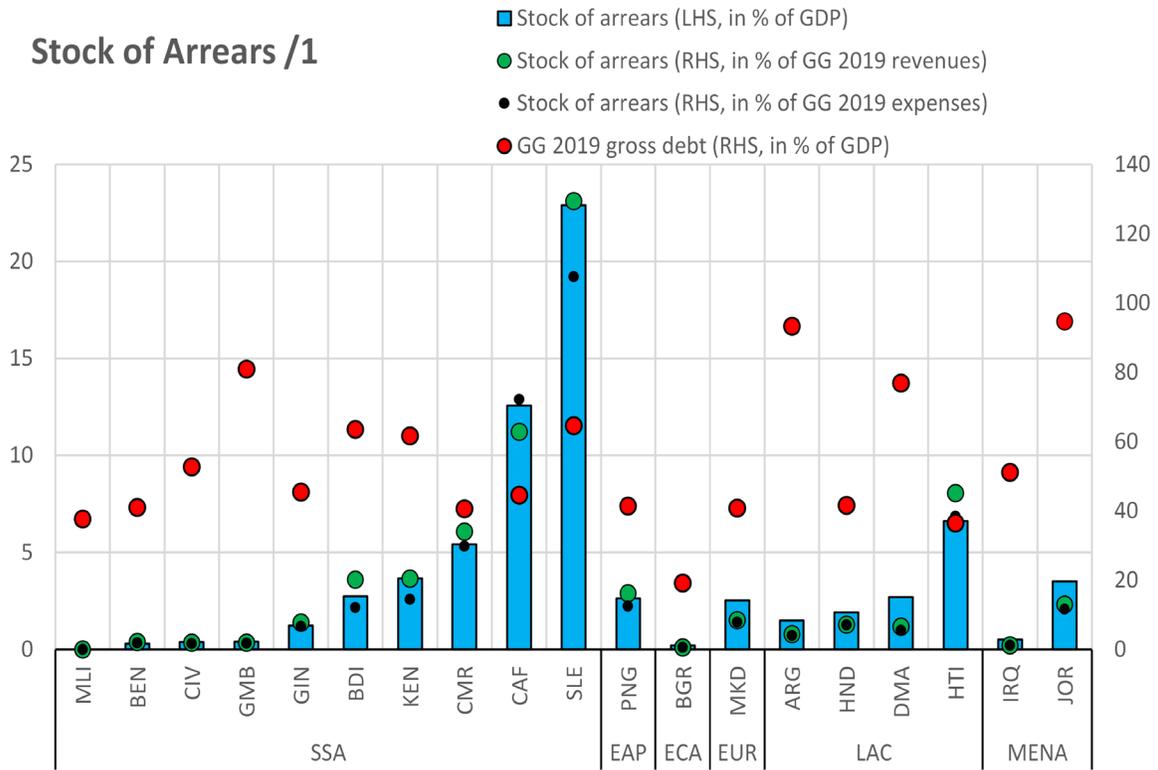
Note: Change in arrears data returned for only 25 countries. Countries with zero change on chart reported no change in arrears position. GG refers to General Government. 2019 fiscal data are used to estimate relative size of arrears for each country and therefore how problematic arrears are.

\*Arrears reported only for salaries.

BDI numbers are estimates.

Sources: WB BOOST Staff Calculations based on WB Country Economist data/emails and IMF WEO

**FIGURE 6 - Stock of Arrears**



/1 Latest dates for stock vary (Jun-20, Mar-20, Jan-20, Dec-19)

Note: Stock of arrears data returned for only 19 countries. GG refers to General Government. 2019 fiscal data are used to estimate relative size of arrears for each country and therefore how problematic arrears are. Net debt data not available for most countries. Gross debt is used instead. BDI numbers are estimates.

Sources: WB BOOST Staff Calculations based on WB Country Economist data/emails and IMF WEO October 2019 vintage.

## >> CONCLUSIONS AND RECOMMENDATIONS

The analysis and data collected indicate that the fiscal pressures created by the COVID-19 pandemic are already resulting in an increase in arrears in some countries. As discussed in this note, delayed payments may manifest themselves as arrears in governments' financial monitoring systems and reporting only after some period of time. As the crisis persists and fiscal buffers are further depleted, there is a significant risk that governments' liquidity problems and the accumulation of arrears will become more widespread. In the following we summarize key actions to prevent and manage the accumulation of arrears due to COVID-19 related fiscal pressures.

**Avoiding arrears accumulation.** Dealing with the structural weaknesses in countries' public expenditure management systems that facilitate the occurrence of arrears requires systemic reforms which require significant time, resources, and political commitment.<sup>8</sup> Nonetheless, in environments where fiscal space is limited and public expenditure systems are weak, short term measures to avoid the uncontrolled accumulation of arrears during the COVID-19 crisis need to be put in place. These include continuous updating of revenue projections to capture the impact of the COVID-19 pandemic, costing of COVID-19 related policy measures, and assessment of available fiscal space including the creation of additional fiscal space through adjustments of non-COVID-19 related expenditures and additional borrowing and mobilization of aid resources. This would feed into budget revision and cash flow management. Given the unpredictability of the health and economic impacts of COVID-19, revenue and expenditure performance will need to be regularly monitored through cash flow management committees with continuous adjustments of expenditure and resource mobilization measures.

**Prioritization of payments and cash management.** To reduce governance risks related to arrears, appropriate cash management processes need to be in place to prioritize payments when cash resources are not sufficient to settle all payments before the due date. Cash management committees are important institutions to manage and prioritize payments. Criteria for prioritization should be spelt out clearly. Key considerations that feed into the prioritization of payments typically include the socio-economic impact to avoid harm to vulnerable households and businesses, the cost associated with delayed payments in terms of interest and penalty charges, and the risk of legal and the risk of disrupting or increasing the cost of essential inputs to public

sector performance. In addition, fiscal multipliers for different sub-categories of current and capital spending can be an important tool to guide government prioritization of payment decisions, helping identify the most consequential categories of payment with the highest fiscal multipliers. Staying current on these high impact categories will ameliorate shocks to short-term and medium-term growth.

To avoid the accumulation of arrears, governments may also seek to renegotiate payment periods and related conditions, especially when liquidity constraints are temporary.

**Strengthening monitoring of arrears.** If arrears are unavoidable, it will be important to establish systems to keep track of payments in arrears. A detailed inventory of arrears should be maintained by the Ministry of Finance. Of particular importance is the monitoring of newly accumulated arrears by subnational government entities, SOEs, and government agencies, which create significant fiscal risks for the central government.

**Settling of arrears.** Good practice for settling arrears requires that it is done on in a systematic way grounded in an arrear clearance strategy. Characteristics of sound arrears clearance strategies include comprehensiveness, i.e. they include all public sector arrears; verification of arrears to ensure that they represent valid claims; transparency, i.e., it sets out a clear timetable and prioritization criteria for the clearance of arrears; and realism and credibility, i.e., credible measures have been adopted to prevent further arrears accumulation and to ensure that resources will indeed be available to settle arrears according to the timetable.

Using the settlement of arrears to insert liquidity into the economy should follow good practice for arrears clearance to reduce the risk of abuse. Arrears clearance is also likely to have very poor targeting for vulnerable entities.

8. See Flynn and Pessoa for a summary of reforms to prevent and manage arrears.

**Securitization of arrears.** Arrears represent unilateral borrowing of government from other economic actors, generating implicit claims on government (Ramos 1998). Securitization of arrears provides creditor with market-negotiable titles to their claims on government. As such, it provides claimants some reassurance about the value and time of settlement of their claims. It also allows them to trade these claims in secondary markets, thus being able to obtain funds (possibly with a discount) earlier. Securitization is typically only a credible policy action as part of a credible arrears clearance plan when the accumulation of new arrears has been stopped. However, in the case of a large external shock such as the COVID-19 pandemic, securitization may be considered by governments that have a credible track record for meeting their obligations.

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Flynn, N. and M. Pessoa. 2014. Prevention and Management of Government Arrears. Technical Notes and Manuals 14/01. Fiscal Affairs Department. IMF. May 2014

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Ramos, A. 1998. Government Expenditure Arrears: Securitization and Other Solutions. IMF Working Paper WP/98/70. May 1998.

World Bank. 1998. Public Expenditure Management Handbook.

## >> ANNEX 1 - COUNTRY INFORMATION

### >>> SUB-SAHARAN AFRICA

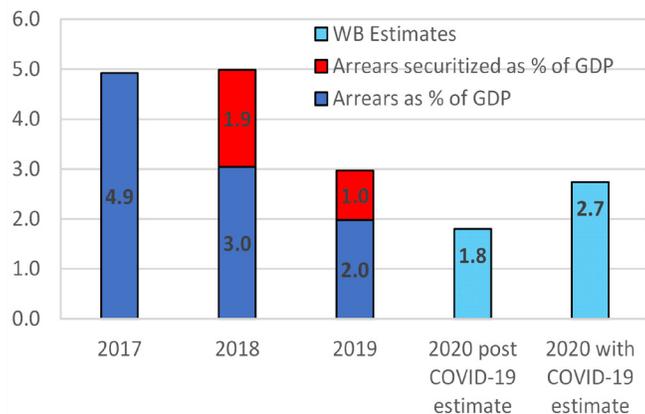
Sub-saharan Africa is the region for which the team has received data and commentary for the largest number of countries. Reports on arrears paint a diverse picture ranging from sharp increases in arrears stocks to countries that have managed to keep stocks unaffected by the liquidity constraints.

In Angola, preliminary reports from the country team suggest that the government continues to reinforce its commitment to regularize arrears, albeit at a slower pace. As such, country economists believe that headline arrears accumulation is not a risk for Angola.

In partnership with the IMF, Benin has committed to reduce arrears in 2020. As of March 2020, there was no arrears accumulation registered and, as of June 2020, the Government of Benin has indicated no difficulties in maintaining its objective of reducing arrears.

In Burundi, while comprehensive information is not yet available, domestic arrears are estimated to have increased. Starting from the budget law of 2018/2019, the Government opted for securitizing arrears into government debt through financial instruments that were purchased by banks. Notwithstanding, pre-covid and post-covid estimates of arrears for the country show an estimated increase by 1 percent of GDP.

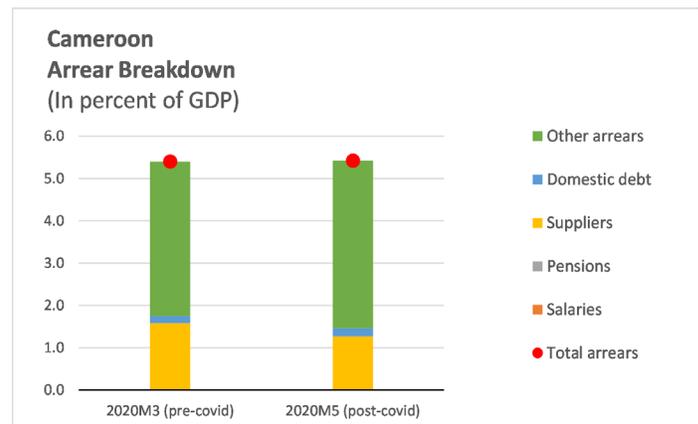
>>> **FIGURE 7 - Burundi: Arrears as % of GDP**



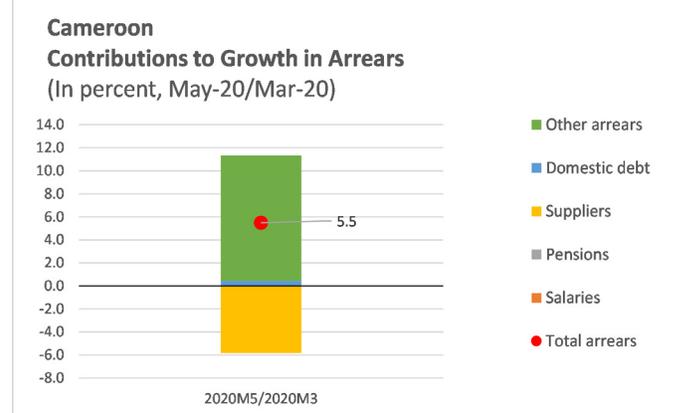
Sources: WB Boost Staff calculations based on data provided by WB Country Economists

Cameroon has kept its headline arrears constant as a share of GDP but altered their composition. Growth in total arrears amounted to 5.5 percent between March and April of 2020. While government arrears to suppliers were reduced, arrears to an unidentified category called “Other” increased markedly. However, there were no reported increases to other categories of arrears such as salaries, pensions, transfers, or domestic debt, suggesting relatively successful management of liquidity.

>>> **FIGURE 8 - Cameroon: Arrear Breakdown**

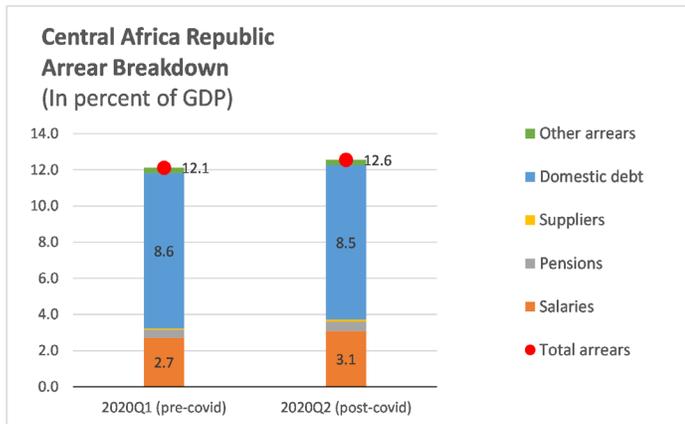


>>> **FIGURE 9 - Cameroon: Contributions to Growth in Arrears**

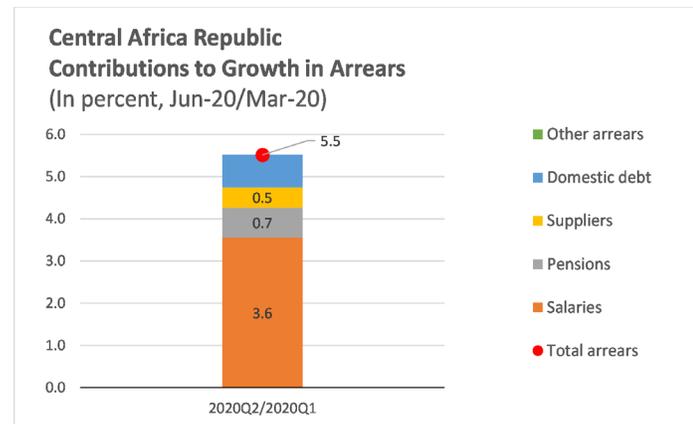


In the Central African Republic total arrears increased from 12.1 % GDP to 12.6% GDP between March and June of 2020. This is also equivalent to a 5.5 percent growth in total arrears with the principal driver being salary arrears, contributing 3.6 percentage points of the total growth of 5.5 percent. Structurally, domestic debt arrears are the biggest component of total arrears pre-and post-covid at around 70 % of total arrears. It remains unclear who is holding this debt and what repercussions this may have on broader macro-financial stability. Coupled with the sharp increase in salary arrears, this is likely to have negative repercussions for economic activity as consumer demand and confidence dwindle further.

> > >  
**FIGURE 10 - Central African Republic: Arrear Breakdown**



> > >  
**FIGURE 11 - Central African Republic: Contributions to Growth in Arrears**

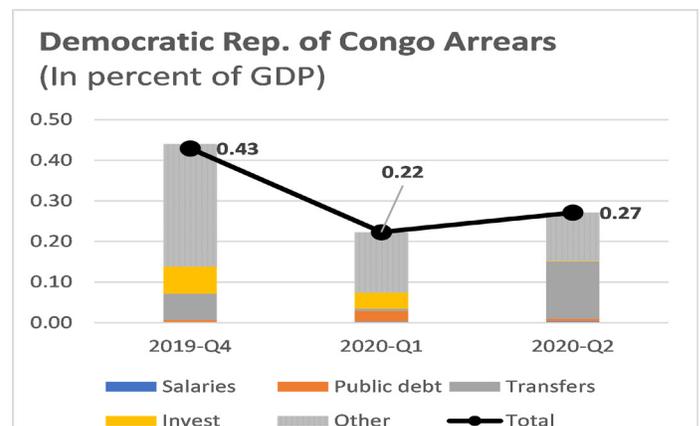


In Chad, the authorities made considerable progress in clearing external arrears and auditing domestic arrears. The restructuring agreement with international commercial creditors in 2018 significantly improved Chad's liquidity position and restored debt sustainability. Domestic arrears

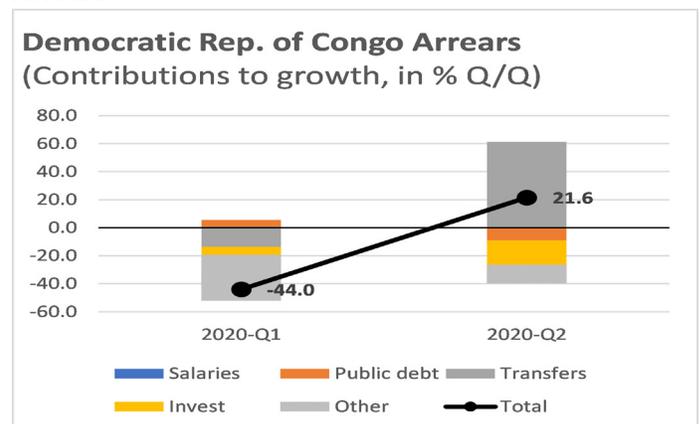
remained constant in recent years because of commitments to zero arrears accumulation under World Bank and IMF reform programs. In 2020, the amount of domestic arrears is expected to decline as authorities settle part of the accumulated arrears. No arrears have been registered thus far in 2020.

In the Democratic Republic of Congo, arrears have increased but still remain at manageable levels. After an aggressive reduction in arrears in 2020Q1, arrears have risen in Q2. The government reduced arrears to suppliers aggressively in both quarters but the increase in Q2 is due to a sharp rise in transfers arrears. Nonetheless, total arrears do not appear to be a significant problem at 0.27 percent of GDP.

> > >  
**FIGURE 12 - DRC: Arrear Breakdown**



> > >  
**FIGURE 13 - DRC: Contributions to Growth in Arrears**



In Cote d'Ivoire, arrears have remained stable and possibly reduced. The government has a zero-ceiling policy on the accumulation of new external and domestic arrears, including those to suppliers and debt service, with close monitoring and control systems in place. In the context of COVID-19, the government accelerated payments of debt to private sector suppliers, but the exact numbers have not yet been reported. The government has confirmed that it remains current on all payments for salaries, pensions, and debt service.

Guinea continues to adhere to its strategy of clearing longstanding domestic arrears that it adopted in 2017. In addition, authorities continue to make good faith efforts to reach a collaborative agreement on external arrears owed to private creditors.

Kenya announced a policy to reduce arrears across the entire public sector as an explicit part of its COVID-19 crisis-fighting response. While no data are yet available on how successful this drive has been in the midst of cashflow and payments pressures, especially for some vulnerable SOEs such as Kenyan Airways and the national power utility company, the clearance of outstanding bills is a key national priority and arrears are expected to be reduced. The total outstanding stock of arrears stands at 3.7 % of GDP.

In Mali, the government is committed to zero accumulation of arrears on domestic and external payments as one of its top priorities in the “Quality Performance Criteria” program. This commitment has thus far been observed under the IMF Extended Credit Facility arrangement that commenced in August 2019. In September 2019, 0.4 percent of GDP in domestic arrears were accumulated but were quickly cleared by end 2019, reinforcing the government’s commitment to this policy. Moreover, 2020Q1 fiscal data shows zero arrears accumulation, with CFAF 107.3 billion (1 percent GDP) as scheduled payments (“fonds en route”, less than three months). 2020Q2 data are not yet available and Mali rarely discloses quarterly fiscal reports. It will take some time to ascertain whether certain scheduled payments have become arrears in 2020Q2 as a result of the liquidity pressures from COVID-19.

Similarly, Niger has hard restrictions on its arrears accumulation and cannot structurally run arrears. Niger successfully eliminated all domestic payment arrears at the end of 2019 as called for under its IMF Extended Credit Facility arrangement. Data through end-April 2020 show that no new arrears have materialized. In addition, there is no reason to

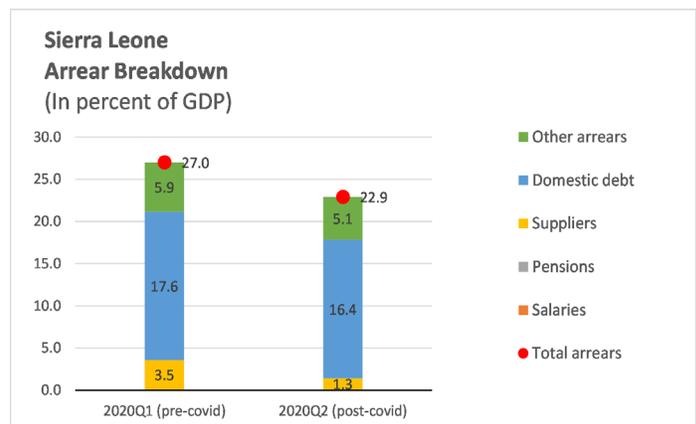
believe that Niger would have accumulated arrears in 2020Q2 because it enjoys access to international capital markets (Niger has recently raised US\$47.4 million in early July 2020) and donors have continued to fulfill funding pledges.

In Senegal, no change in arrears has been recorded so far. Moreover, faster payment and arrears repayment schedules have been proposed as part of the governments Covid-19 response.

Sierra Leone has kept the growth in arrears in check by significantly altering the composition of arrears. The government has kept its salaries arrears at zero and has managed to bring down its total arrears between 2020-Q1 and 2020-Q2 by 2 percentage points. It has done this by aggressively reducing arrears to suppliers by 60 percent at the expense of debt holders, whose arrears increased by 10 %, a substantial spike given the fact that historically, debt arrears have represented the largest component of total arrears (70 percent of total arrears and 16-17 percent of GDP).

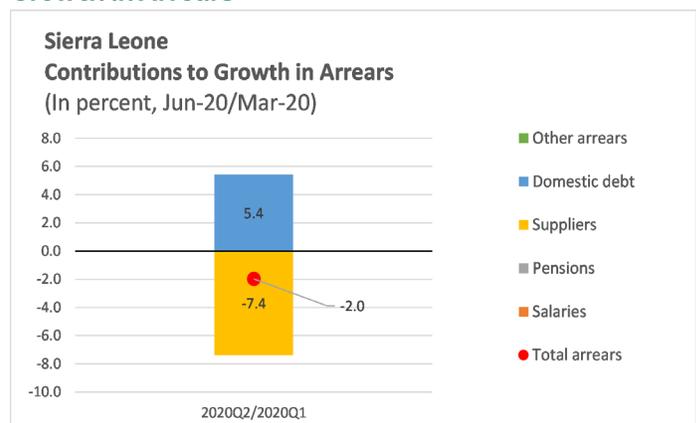
> > >

**FIGURE 14 - Sierra Leone - Arrear Breakdown**



> > >

**FIGURE 15 - Sierra Leone - Contributions to Growth in Arrears**



## >>> EAST ASIA & PACIFIC

In East Asia and Pacific region, data were only reported for a few countries with Papua New Guinea as the only country where COVID-19 may impact arrears. In Kiribati, COVID-19 has not introduced any liquidity constraints as the country has large cash reserves and its fisheries revenues seem unaffected by the pandemic. Similarly, Philippines and Thailand reported no liquidity constraints. While information is not available for Myanmar, given strict rules and regulations, the size of arrears has historically been very small accounting for less than 0.001% of GDP. In Papua New Guinea, as of end-2019, the government estimated arrears to be close to USD 583 million (2.6 percent of GDP). The government was planning to clear half of these arrears in 2020 but the COVID-19 crisis is expected to lead to a substantial revenue shortfall. Government estimates a shortfall of USD 640 million and extra spending on health and economic relief measures (USD 175 million package approved by the government). Most likely, these will alter government's plans for clearing arrears. This will be confirmed by the government in its mid-year reporting, expected by end of July 2020.

## >>> EUROPE & CENTRAL ASIA

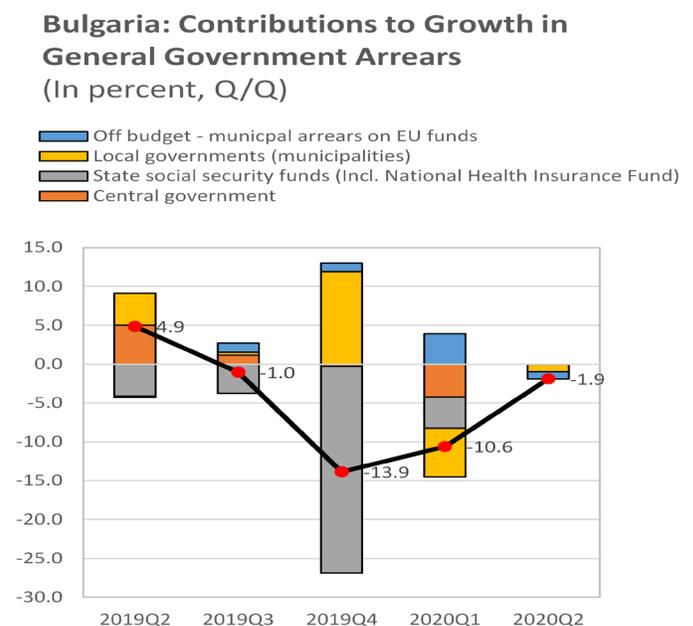
In ECA, initial reports from country teams suggest that most of arrears are expected to come mainly from SOEs. This is typically an area of the public sector for which there is usually less timely data, and when available, is highly fragmented. Arrears accumulation is likely to affect SOEs in the communications sector, the transport sector, and the energy sector. However, in the energy sector, the low price of oil is an ameliorating factor for SOEs in oil importing countries. Further data mining will be needed in order to better understand arrears dynamics in SOEs across the region.

Anecdotally, in Serbia, the national airline and telecommunications corporations are in a dire financial situation. Utility payments have been postponed, and it is not clear yet if local governments are budgeting for these revenue shortfalls. Liabilities could be mounting in sectors for which a paucity of oversight is provided in the short run, even during ordinary times. In Tajikistan, only salary arrears were reported and although they jumped by 50 percent from pre to post-covid, they only represent 0.02 percent of GDP.

In Bulgaria, although at a diminished rate, the government is following through on its commitment to clear as much arrears

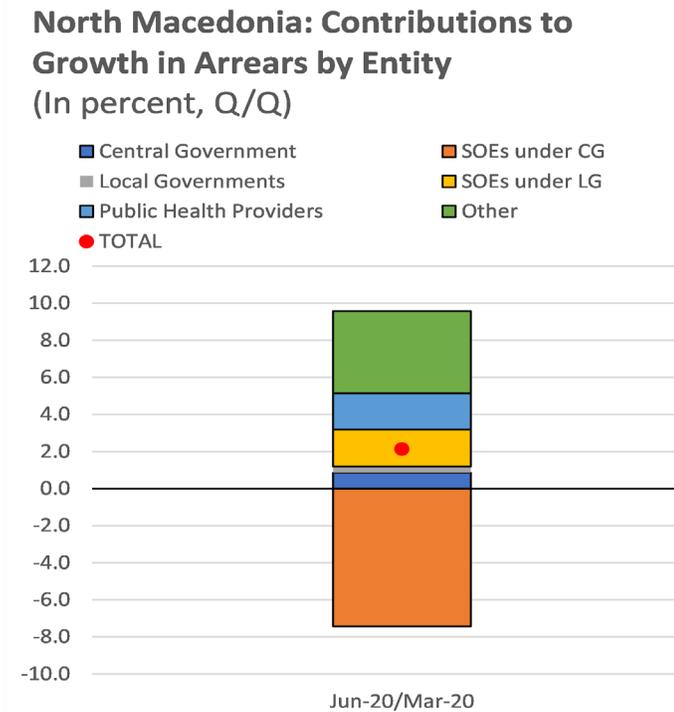
as possible. This is due primarily to reduction of central government arrears and to the repayment of arrears owed by the national health insurance fund in late 2019 and 2020. The state social security fund arrears were due primarily to hospitals and the accumulation of such arrears to hospitals is nothing new. They are usually resolved through a transfer from the central government. Municipalities' arrears have also marginally declined in 2020Q2. Arrears by municipalities account for slightly more than one-third of all general government arrears, and include arrears to suppliers of construction works, waste management services and utilities, amongst others.

>>>  
**FIGURE 16 - Bulgaria: Contributions to Growth in General Government Arrears**

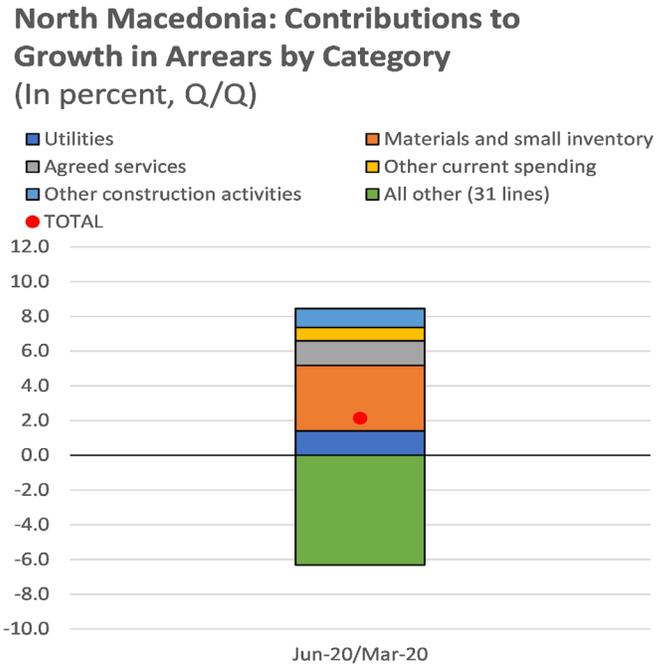


Finally, in North Macedonia total arrears have inched up by 2.1 percent at the end of 2020Q2. While there has been a marked reduction in SOE arrears under the central government, arrears in SOEs under local governments and public health provider and other arrears were the main drivers. The bulk of the increase in arrears from 2020Q1 to 2020Q2 were in payments for materials and small inventory, utilities, and other services. Nonetheless, this increase in total arrears represents only around 0.05 percent of GDP.

> > >  
**FIGURE 17 - North Macedonia: Contributions to Growth in Arrears by Entity**



> > >  
**FIGURE 18 - North Macedonia: Contributions to Growth in Arrears by Category**

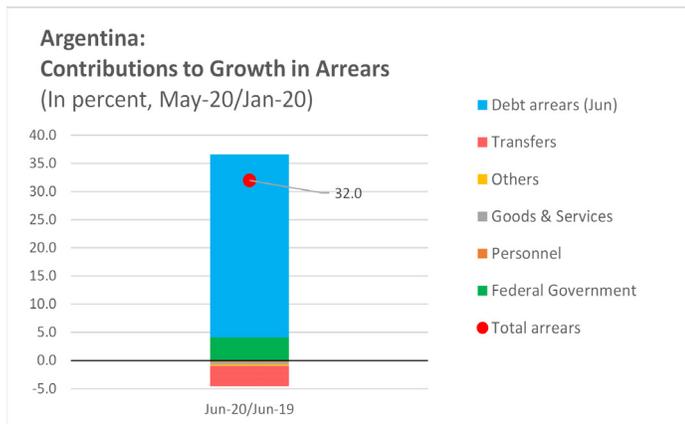


## >>> LATIN AMERICA & THE CARIBBEAN

In Latin America and The Caribbean, country economists reported little accumulation of arrears, reflecting historical fiscal discipline in mitigating accumulation of arrears, which was exhibited and reinforced during the global financial crisis of 2007-08 and the commodity price crash of 2014. However, there are a few notable exceptions: principally Argentina, Haiti, Costa Rica, and Guatemala. These countries might warrant further monitoring.

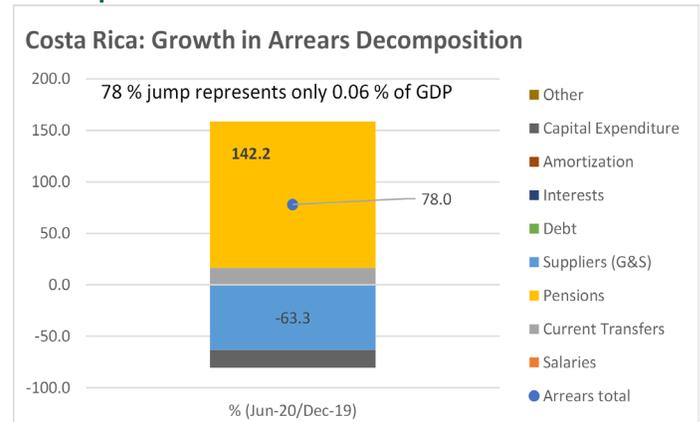
In Argentina, arrears increased significantly by 32 percent between January 2020 and May 2020. Arrears were reduced in the categories of salaries and transfers but maintained at the same level in the category of suppliers of goods and services. Debt arrears, however, skyrocketed, contributing more than 30 percent of the growth in total arrears. Notwithstanding this large jump in nominal arrears, relative to GDP total arrears registered a marginal increase of 0.2 percent of GDP.

> > > **FIGURE 19 - Argentina: Contributions to Growth in Arrears**

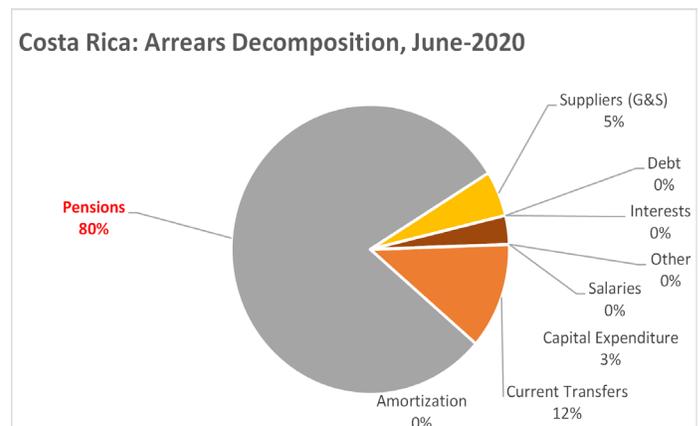


In Costa Rica, arrears jumped by 78 percent, pulled in opposite directions by arrears in pensions and arrears to suppliers of goods and services. Pension arrears were non-existent prior to the COVID-19 outbreak, but now represent 80 percent of total arrears. Coupled with current transfers, these arrears account for 92 percent of total arrears, suggesting that the most vulnerable might not be receiving the kind of assistance they require, or are accustomed to, and that the government of Costa Rica is running into cash constraints. Costa Rica also simultaneously reduced arrears to suppliers aggressively, perhaps because of the collapse in demand for government goods and services not related to combating COVID-19. Total arrears at end of 2020-Q2, however, represented only 0.12 percent of GDP, are small relative to the country's fiscal position and do not appear to be problematic for the time being.

> > > **FIGURE 20 - Costa Rica: Growth in Arrears Decomposition**

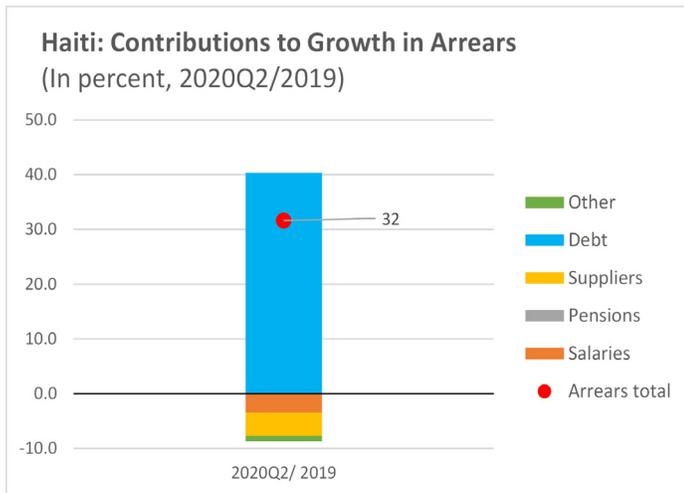


> > > **FIGURE 21 - Costa Rica: Arrears Decomposition**



Haiti's total arrears also shot up by 32 percent between June 2020 and December 2019. Haiti reduced its arrears to employees, suppliers, and "other" category but simultaneously increased its debt arrears position. In fact, all the growth in total arrears came from increases in debt arrears, suggesting that Haiti might be running into liquidity constraints and passing along the buck to creditors in order to remain current on its other obligations. For Haiti, this is particularly troubling since its stock of arrears is larger than that for its regional peers, hovering in the 5-7 percent of GDP range.

> > >  
**FIGURE 22 - Haiti: Contributions to Growth in Arrears**



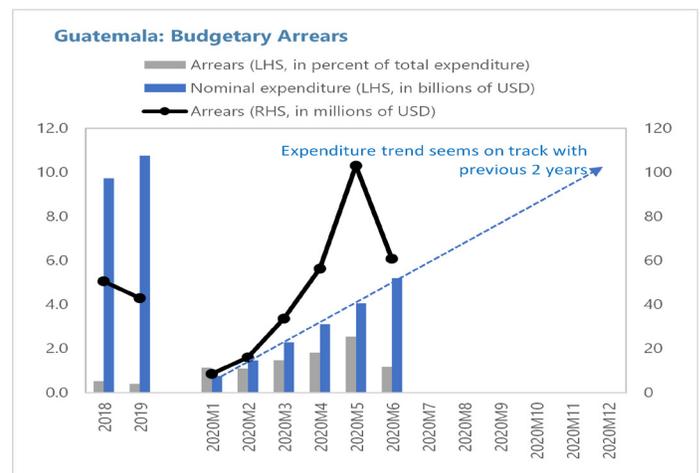
In the Caribbean, Dominica has stayed current on its obligations by maneuvering on the income side. It has been diverting revenue earmarked for other non-essential construction projects to finance arrears clearance and extraordinary covid-related spending. In addition, Dominica continues to be current on its debt servicing, salary payments and pension contributions. Arrears to suppliers are declining, albeit at slower rate than anticipated pre-covid. While COVID-19 has had an impact on the fiscal position, the stock of arrears continues to decline, though at a rate slower than expected pre-covid. Arrears as of July 2020 totaled 2.7% of GDP and are principally amounts owed to suppliers who helped with the reconstruction efforts after successive hurricanes caused damages estimated at 220 percent of GDP.

In Honduras, the fiscal responsibility law establishes a ceiling on the accumulation of arrears by the central government. This law has not been suspended, despite recent calls to utilize its escape clauses. There is a hard and legally binding upper bound of 0.5 percent of GDP on total arrears of the central government. In addition, liquidity is unlikely to be problematic

for Honduras as recent credit operations have yielded substantial resources. It remains unclear if the government will experience a need for running arrears as the crisis unravels. In addition to the central government, SOEs might be at risk of running into trouble. The state electricity company (ENEE) has been in financial distress for several years and has been experiencing a new buildup of arrears to generators (estimated at US\$100 million by end-June 2020) that cannot be eliminated in the short-run. The authorities are expected to clear these new arrears by end-2020 by using the funds from a recent placement of a sovereign bond. According to the IMF program targets, ceiling on the accumulation of domestic arrears (and new external arrears) by ENEE is set at zero. As of April 2020, this hard ceiling has not been breached. Prior to COVID-19, and at the inception of the new IMF program (July 2019), ENEE accumulated arrears to private generators of around 1.5% GDP.

Similarly, Guatemala has also seen its arrears rise as a result of COVID-19. The WB team reports that while public arrears were never flagged as a salient issue in Guatemala beforehand, the COVID-19 crisis has conspicuously impacted the government's ability to honor obligations. Historically, arrears have been at 0.5% of spending in 2018 and 2019 but jumped up to a high of 2.5 percent of GDP in May 2020 before dropping back to the higher year-to-date 2020 average of 1.2 percent of expenditure by June 2020. Government expenditure in Guatemala does not seem to have collapsed since cumulative spending for the first half of 2020 appears to be in line with the trajectory of spending in the previous two years. It is unlikely that government demand for goods and services completely collapsed as nominal growth in 2020 over 2019 spending is at trajectory of -3.4 %.

> > >  
**FIGURE 23 - Guatemala: Budgetary Arrears**



In the case of Peru, the COVID-19 crisis has not led to the occurrence of any payment arrears. The government continues to have ample savings and liquidity available to meet its payment obligations. While there are some payment arrears at the subnational level, these are the legacy of the past failures of the local authorities to pay social security contributions for its employees many years ago and are not affected by the ongoing crisis.

In other southern cone economies, data are not yet available, or arrears do not appear to be problematic yet. In Brazil, expenditure arrears are classified as arrears only if they are not paid by the end of the calendar year, masking a potentially large arrears accumulation caused by COVID-19. In Colombia, and by legal decree, no entity of the government can accrue expenditure if it does not have funds to make payments. This would imply that there cannot be arrears as such. In Uruguay, there is no evidence of an uptick in arrears attributable to the pandemic. Moreover, there are no debt arrears to date. In Paraguay, no arrears data is published but WB colleagues report that Ministry of Finance is unaware of any arrear accumulation.

### >>> MIDDLE EAST & NORTH AFRICA

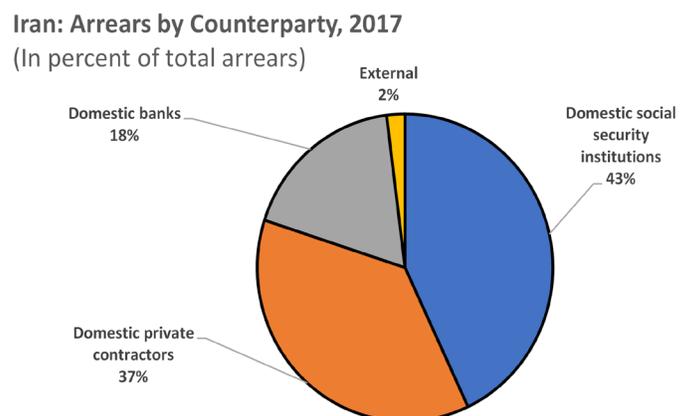
In MENA, arrears accumulation is a structural issue independent of COVID-19 but has certainly been exacerbated by the sharp drop in revenues brought about by COVID-19. Arrears accumulation was prevalent in the region, including in high income countries such as Saudi Arabia, and has been a backburner issue for many years, becoming particularly prominent in periods of oil price declines. Furthermore, arrears in the MENA region are particularly concentrated for suppliers, vendors and contractors with governments generally keeping current on other categories such as wages. In addition, it is expected that payments for SOEs and public utilities have been delayed.

In Algeria, it is expected that fiscal risk will soon materialize due to government financial support to SOEs. Given the severe shock to fiscal revenues, exacerbated by the economic toll of containment measures on SOEs, and the high costs of fiscal policies to support firms and households, the government is likely to incur large domestic payment arrears, especially to public utilities, with repercussions to banking liquidity and the real economy. Some sectors, however, might experience a more moderate buildup in arrears as a result of the lockdown measures because of the decrease in government consumption of goods and services and in total consumption

of subsidized goods and services such as energy, transport, and construction.

In Iran, structurally higher stocks of arrears that predate COVID-19 are exacerbating the shock and forcing the government to resort to extraordinary measures to generate and recognize revenue to meet its spending obligations. While recent data on public sector arrears are not published by the authorities, as of 2017 total arrears stood at 30 percent of GDP, almost exclusively as arrears to domestic creditors (0.5 percent of GDP are owed to external creditors). These domestic arrears are primarily owed to social security institutions, private contractors, and domestic banks. These high stocks of arrears and the severity of the economic shock to fiscal balances from COVID-19 have caused the government to resort to extra-ordinary measures to keep arrears in check in order to meet its financial obligations. The government has resorted to four main strategies: 1- securitizing its arrears and selling these instruments to domestic banks, 2- netting out taxes from payments due to the government by counterparties, 3- selling financial assets and shares in SOEs, and 4- making withdrawals from the national development banks. Media reporting suggests that a substantial share of arrears is in salary arrears, other labor compensation to the public sector, including pension funds, Social Security Organization (SSO), municipalities, SOEs and the banking sector. Coupled with the collapse in oil prices and oil revenues, all of these extraordinary behaviors suggest that Iran is likely to be in a very uncomfortable fiscal position.

> > >  
**FIGURE 24 - Iran: Arrears by Counterparty**

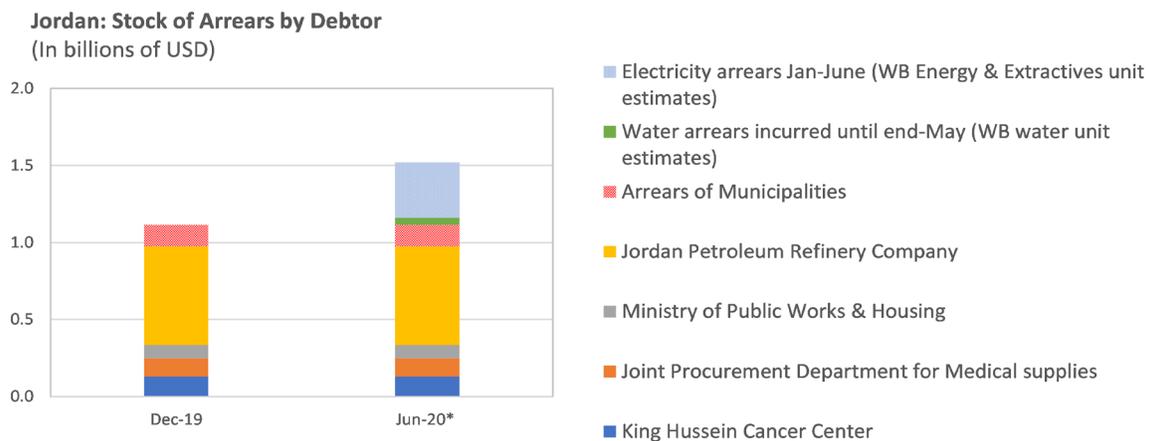


In Iraq, the COVID-19 shock has been so severe that it has resulted in the suspension of transfers from the central government to the Government of Erbil (42 percent of Erbil's fiscal revenues). Pre-covid arrears on external and domestic debt are estimated at 0.5 percent of GDP. At its worst oil price shock and simultaneous ISIS conflict in 2015, the government accumulated arrears in the order of magnitude of 5 percent of GDP. WB team estimates suggest that oil prices would need to surpass a minimum threshold of USD 58 per barrel for Iraq to meet its wage and pension obligations alone. Average oil prices for the first half of 2020 did not exceed US\$35 and rigid expenditure categories such as wages continue to rise. As such, it is very likely that Iraq will run large arrears if the price of oil does not recover.

In Jordan, the government is rapidly adding to its known stocks of arrears due to SOEs. The principal component of these arrears is for the energy sector through the national petroleum refinery company. By June 2020, WB staff estimate that the stock of arrears increased to USD 1.5 billion, an almost 50% increase in arrears attributable to just the electricity and water sectors.

> > >

**FIGURE 25 - Jordan: Stock of Arrears by Debtor**



Sources: WB country team estimates and IMF IFS for end of period exchange rates.

In Morocco, WB staff believes there is no risk of arrears accumulation as additional expenditures and liquidity needs will be financed by a COVID-19 fund.<sup>9</sup> Additional mitigating factors on fiscal pressure and the accumulation of arrears include the withdrawal of energy subsidies and the rationalization measures planned for a revised budget law, aimed at capping wages and instating hiring freezes. In addition, in April 2020, Morocco accessed USD 3 billion through its IMF Precautionary and Liquidity Line (PLL), further reducing the risk of running into liquidity crunches that would otherwise result in accumulation of arrears. Since then Morocco has also launched (i) a guarantee fund (7% of GDP) also available to SOEs; (ii) a strategic investment fund (4% of GDP), also available to SOEs. The combination of these factors allows commercial SOEs to increase their borrowing

from banks, including for working capital. Finally, the central bank has increased its refinancing of banks and allowed for extended maturities, with eligibility granted for working capital loans.

9. SOEs: Morocco has an observatory of payment delays, with data for each SOE (commercial and not commercial) going back a couple years.

## >>> SOUTH ASIA

While no recent data is available for SAR, the sources leading to a build-up in arrears in SAR typically include few prominent categories. These include government arrears to the state-owned electricity utility and, with the advent of COVID-19, other infrastructure service-providers (Afghanistan); payments for goods/services/public works and expenses related to staff salary/ allowances (Nepal); payments to local contractors and suppliers (especially on infrastructure projects) and inter-SOE payments (Sri Lanka); central government arrears stemming from deferment of certain subsidy payments, subnational transfers, increases in salary/allowances (post-COVID-19) as well as SOE arrears (India).

In India, and in contrast to normal times, the central government and several state governments are deferring pay increases and payment of allowances to employees. However, clearances of past arrears in the rural employment guarantee program and to small firms are being expedited as a part of COVID-19 support measures. For now, deferment of debt service payments in India is not expected, however, faced with an unprecedented fiscal crunch, the government may postpone recognition of payments arising from COVID-19 related shocks, which might lead to a large build-up of arrears in the coming. This phenomenon might be exacerbated through off-budget financing of some payments in order to keep 'official' fiscal deficits under control. These trends were already evident in India, in the years prior to the advent of COVID-19, when arrears on the payment of food and fertilizer subsidies were deferred and public agencies were encouraged to borrow from public sector banks and small savings fund to finance their operations. Moreover, in the past, the central government has delayed transfers to subnational governments when faced with a tight fiscal situation. Given the fiscal stress caused by COVID-19, the government might decide to opt for similar maneuvers, although for the time being arrears on this account seem to have been reduced so far.

In addition, it is worth monitoring developments in SOEs. Stressed public sector enterprises such as Air India, the national carrier, could see an increase in arrears due to the impact of COVID-19 on their operations. Some public sector undertakings (PSUs) could see an increase in arrears payable to the central government due to an ongoing court hearing on license fees for mobile spectrum which is still being decided. At the subnational level, arrears in payments to power generation companies by state-owned power distributions companies are rising but the central government has taken steps to refinance these companies. This will lead to a reduction in arrears going forward. However, reduced electricity demand is putting renewed stress on utility finances.

## >> ANNEX 2 - RESPONSES FROM COUNTRY ECONOMISTS

QUANTITATIVE/ QUALITATIVE DATA	NO DATA/SUFFICIENT INFORMATION
Algeria	Afghanistan
Angola	Antigua
Argentina	Bangladesh
Benin	Barbuda
Brazil	Belize
Bulgaria	Bhutan
Burundi	Burkina Faso
Cameroon	Cabo Verde
Central African Republic	Congo (Rep. of)
Chad	Equatorial Guinea
Colombia	Federated States of Micronesia
Congo (DRC)	Fiji
Costa Rica	Ghana
Cote D'Ivoire	Guinea-Bissau
Dominica	India
Gabon	Liberia
Gambia, The	Maldives
Guatemala	Marshall Islands
Guinea	Mauritania
Haiti	Nauru
Honduras	Nepal
Iran	Nicaragua
Iraq	Nigeria
Jordan	Pakistan
Kenya	Palau
Kiribati	Samoa
Mali	Solomon Islands
Morocco	Sri Lanka
Niger	Timor-Leste
North Macedonia	Togo
Papua New Guinea	Tonga
Paraguay	Trinidad & Tobago
Peru	Tuvalu
Philippines	Vanuatu
Senegal	
Sierra Leone	
Tajikistan	
Thailand	
Uruguay	

## >> ANNEX 3 - CAVEATS TO DATA AND ANALYSIS

- 1 There are little up-to-date data for Q2, Q1 2020 for some countries.
- 2 For some countries, high-frequency data do not exist, aren't published by authorities, or aren't collected by teams
- 3 There are different definitions of what "arrears" are among countries
- 4 There are different time frames for arrears triggers among countries (30 days, 90 days, 120 days, or only at end of fiscal year trigger)
- 5 There is little clarification if arrears data provided are stock vs. flow and reporting is possibly inconsistent among countries
- 6 The definition of government is not clear in some countries and possibly inconsistent among countries (central vs. local vs. entire public sector)
- 7 Disaggregation of arrears by economic sub-category is not available in most countries
- 8 Period over period definition for calculations and comparison changes from country to country because latest data point available varies from country to country

