

International Monetary Fund

African Department



DOMESTIC ARREARS IN SSA: SIZE, SYMPTOM AND CURES

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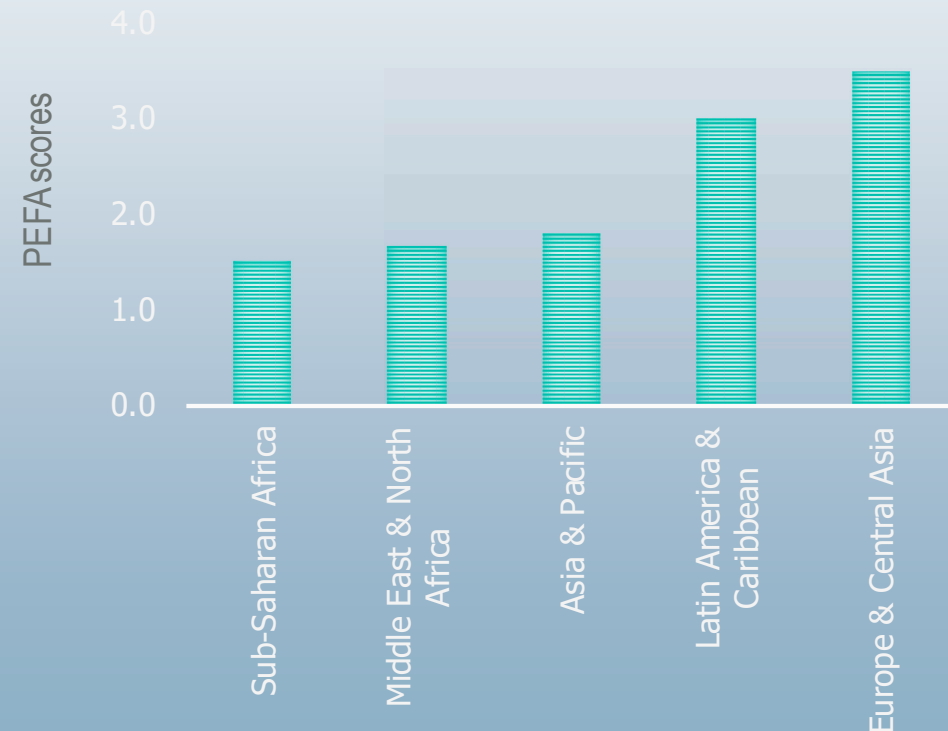


Why we should care (1)

Domestic arrears are significant in SSA

- ▶ 70 percent of sub-Saharan African countries report domestic arrears
- ▶ Sub-Saharan Africa has the lowest PEFA (Public Expenditure and Financial Accountability) score for the domestic arrears

PEFA Scores for Domestic Arrears Stock
(Higher score indicates lower stock of arrears)

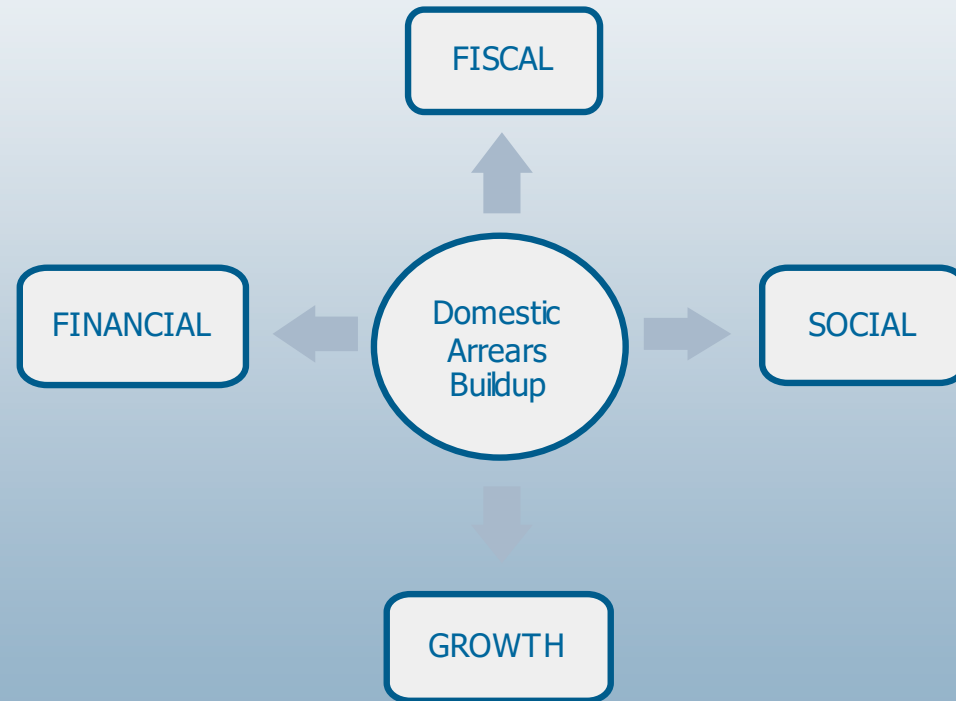


Source: PEFA 2016 methodology, and IMF staff calculations.



Why we should care(2)

Domestic arrears have detrimental macroeconomic effects



- ▶ Despite the prevalence of arrears, their causes and effects are not well-understood
- ▶ The literature on domestic arrears is very limited
- ▶ Their true scale and cost may be hidden
- ▶ Little operational guidance exists as to the best practices on arrears clearance

Sources: IMF staff calculations..



Key messages

- **Domestic arrears are prevalent in sub-Saharan African countries and have increased in recent years**
 - ▶ Most SSA countries officially report expenditure arrears, but also have “unrecognized” arrears
 - ▶ After declining steadily in the late 2000s, arrears have increased recently
- **They have widespread macroeconomic, financial and social consequences**
 - ▶ They negatively affect the private sector
 - ▶ Arrears accumulation can lead to stress in the banking system
 - ▶ They undermine trust in government and the effectiveness of fiscal policy
- **Country authorities should make every effort to clear existing arrears and prevent arrears accumulation**
 - ▶ A clearance strategy entails three main steps: verification, payment and prioritization strategy, and repayment
 - ▶ Preventing the accumulation of arrears requires a combination of PFM reforms, sound fiscal policy, and political commitment

Roadmap

- **Stock taking of domestic arrears in SSA**
 - ◆ Causes of domestic arrears accumulation
 - ◆ Macroeconomic effects of domestic arrears
 - ◆ Cures: clearance and prevention of domestic arrears



Dataset

● Challenges

- ▶ No existing database on domestic arrears
- ▶ Absence of standardized definition and coverage of public sector

● Staff approach to collect data

- ▶ Survey among IMF African Department desk economists
- ▶ Supplemented with information from IMF Staff Reports
- ▶ Cross-checked against data included in public expenditure and financial accountability assessments (PEFA)

● Looking ahead

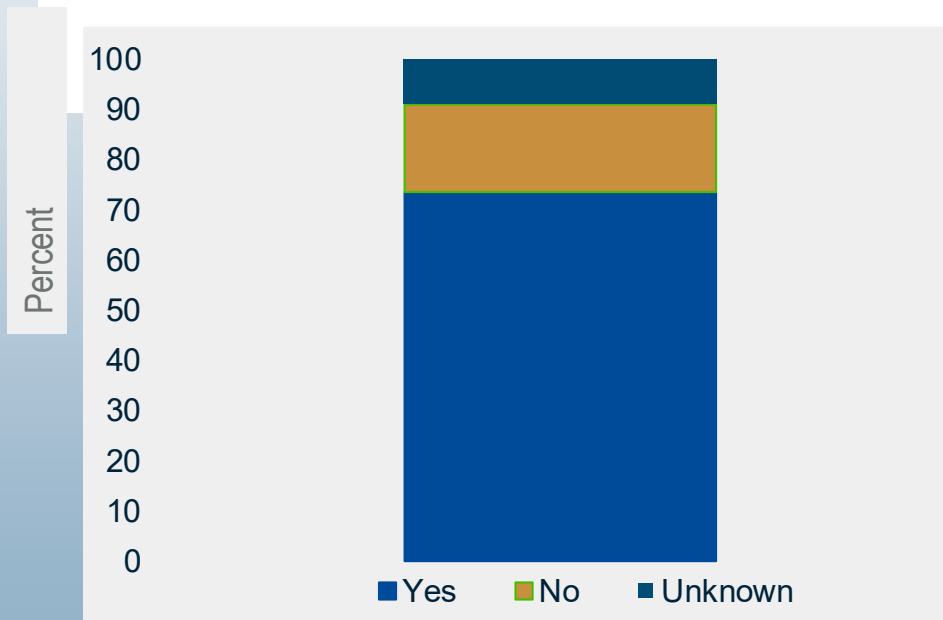
- ▶ More work needed to build a comprehensive database, based on more regular and methodical reporting and better monitoring systems across the region



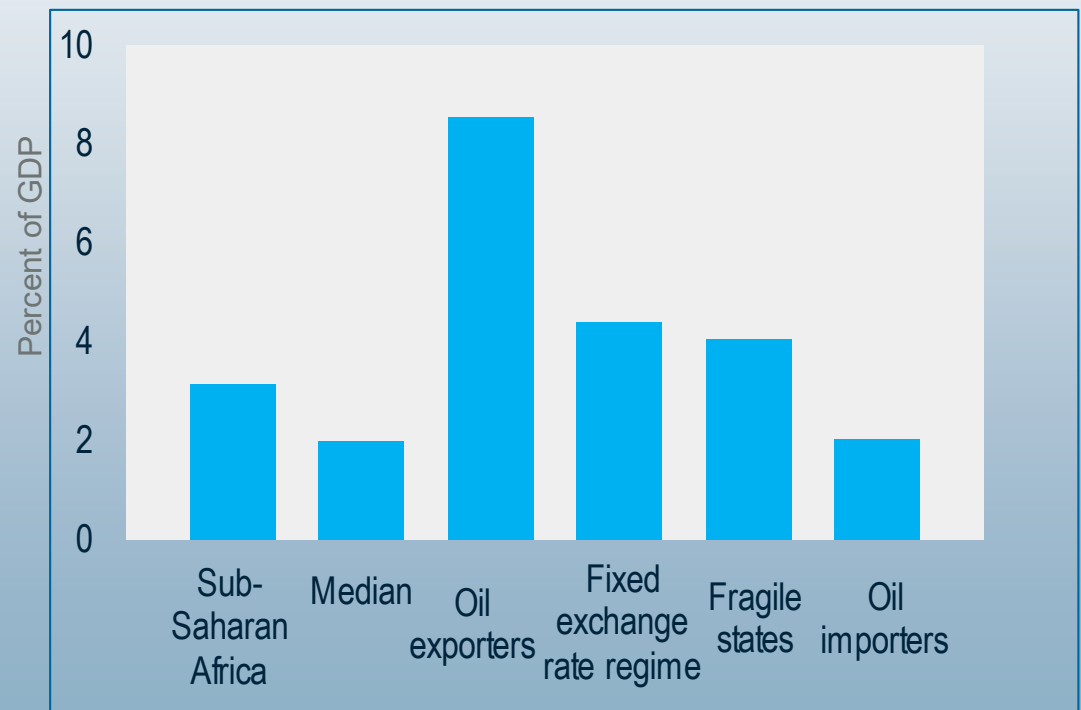
Stock taking of domestic arrears in SSA (1)

A majority of SSA countries report domestic arrears

Share of Countries with Recorded Domestic Arrears in Sub-Saharan Africa, 2018



Sub-Saharan Africa: Stock of Domestic Arrears by Country Group, 2018



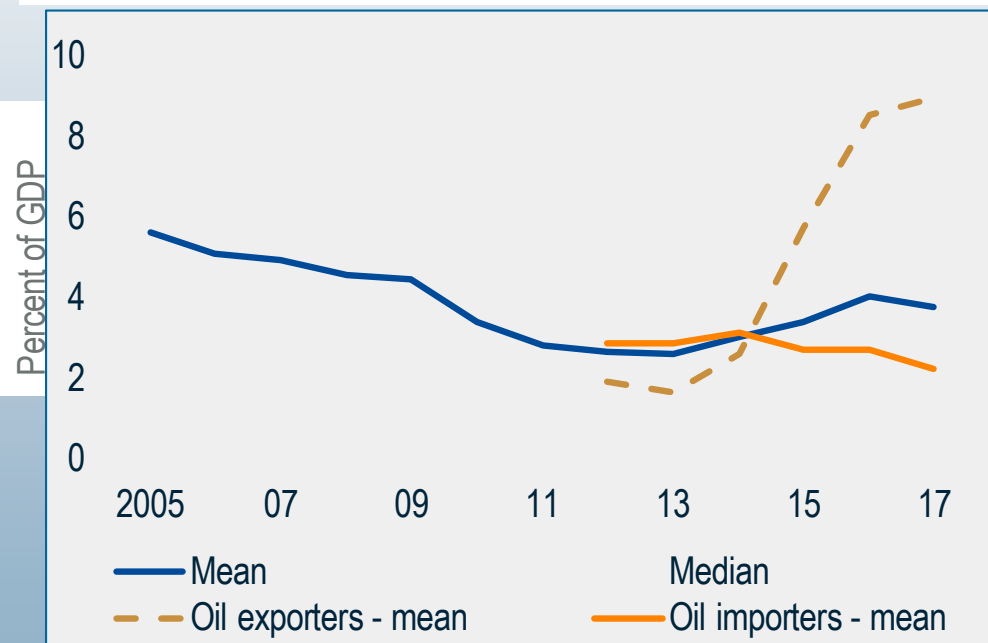
Sources: IMF staff calculations..



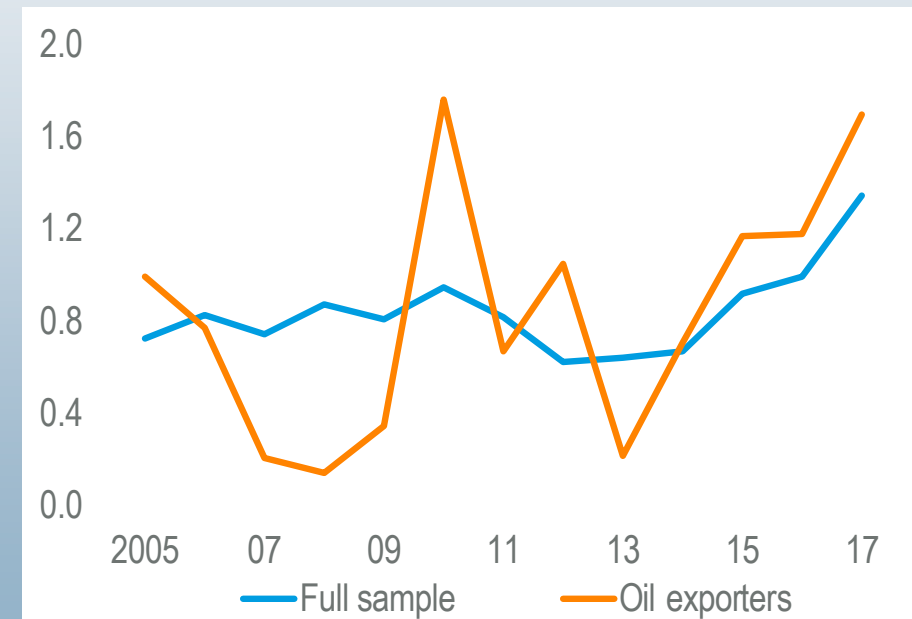
Stock taking of domestic arrears in SSA (2)

Domestic arrears have increased since 2013 in SSA, especially in oil-exporting countries

Stock of Domestic Arrears in Sub-Saharan Africa, 2005–17



Sub-Saharan Africa: Frequency of Domestic Arrears-Related Terms in IMF Staff Reports, 2005–17



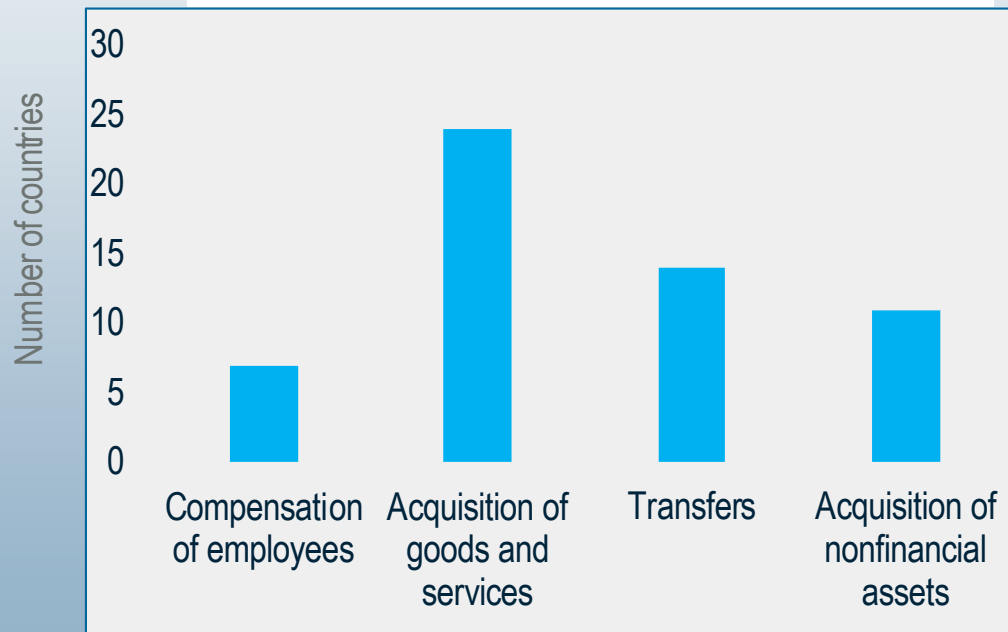
Sources: IMF staff calculations..



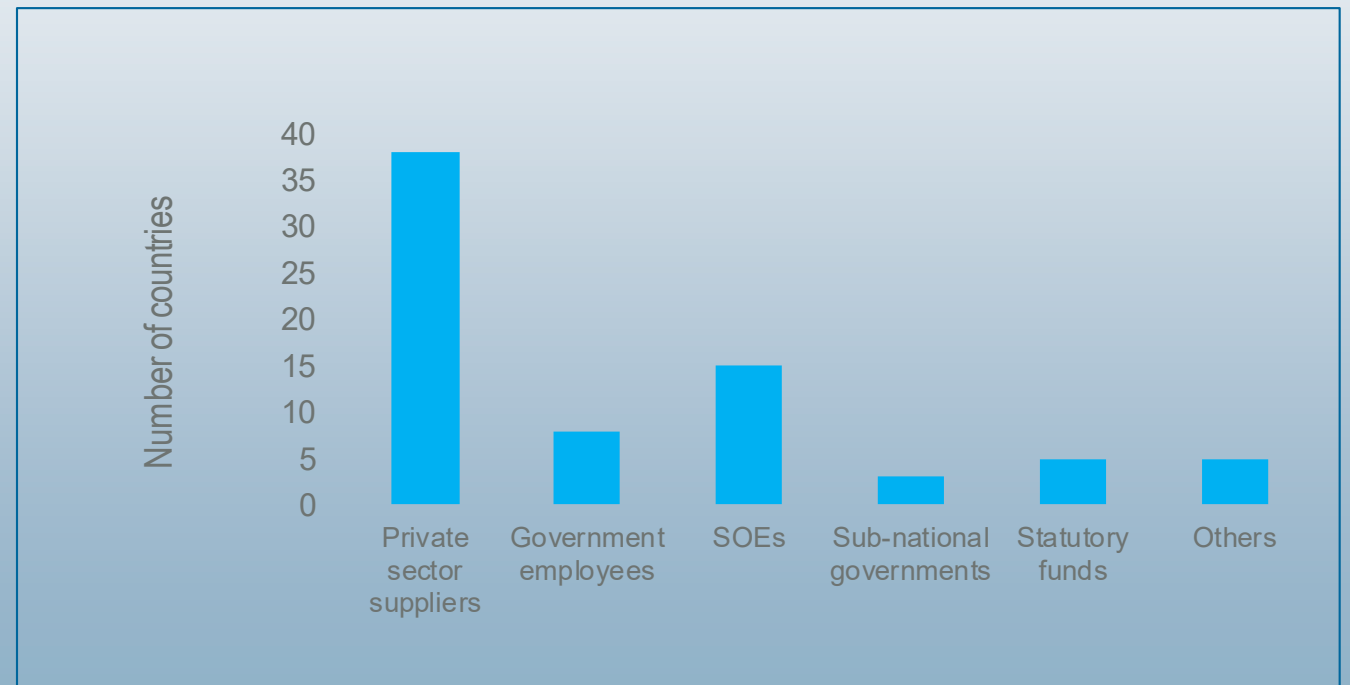
Stock taking of domestic arrears in SSA (3)

Arrears to private suppliers of goods and services are the most common

1. Domestic Arrears by Spending Category



2. Domestic Arrears by Economic Agent



Source: Survey of IMF African Department desk economists.

Roadmap

- Stock taking of domestic arrears in SSA
- ◆ **Causes of domestic arrears accumulation**
- ◆ Macroeconomic effects of domestic arrears
- ◆ Cures: clearance and prevention of domestic arrears



Causes of arrears accumulation (1)

Countries accumulate expenditure arrears due to both structural and cyclical factors

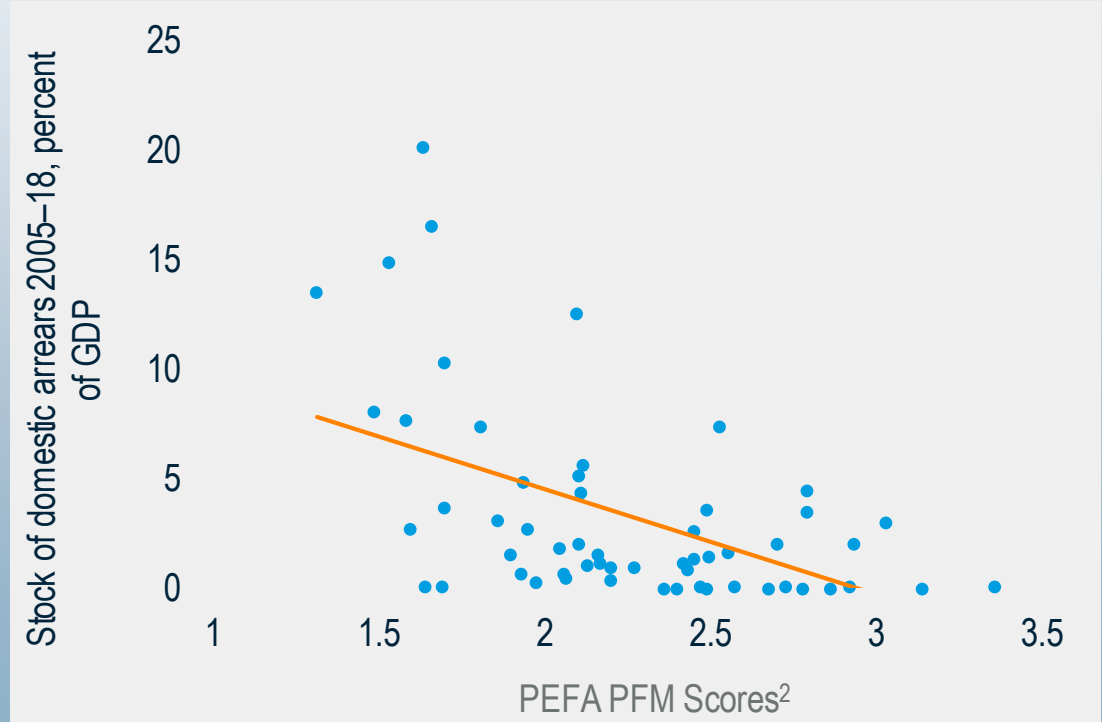
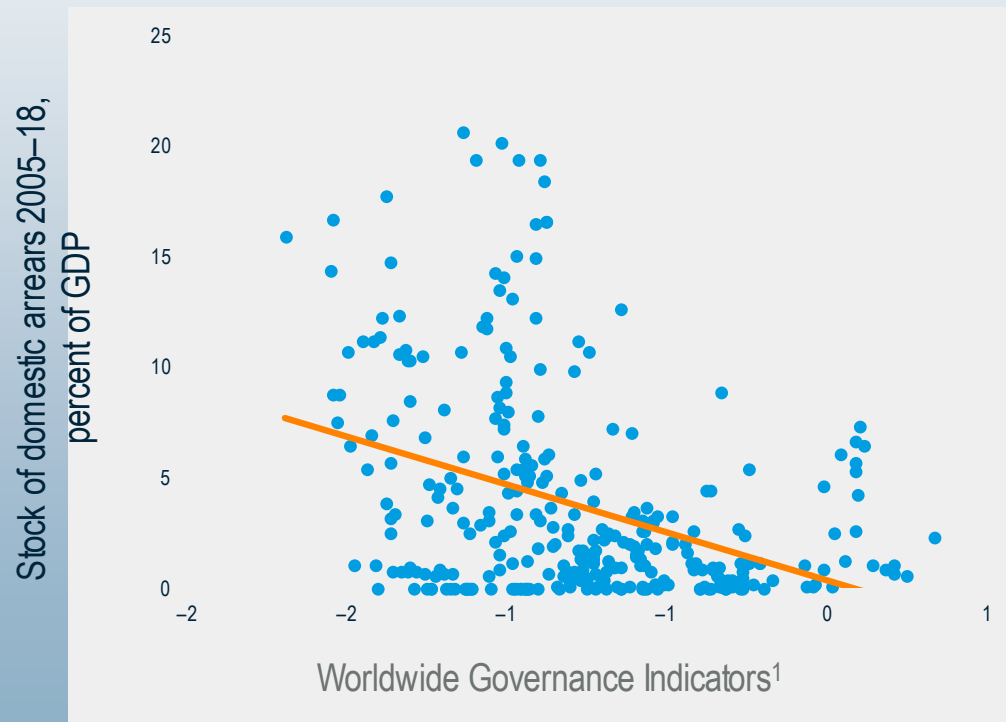
- **Structural causes include weak fiscal and PFM institutions, notably:**
 - ▶ The formulation of unrealistic budgets
 - ▶ A lack of commitment controls
 - ▶ Poor cash management
 - ▶ Delays in processing payments
- **Cyclical factors are primarily those that adversely impact government resources like:**
 - ▶ Economic downturns
 - ▶ Commodity price shocks
 - ▶ Internal shocks such as conflict and political instability



Causes of arrears accumulation (2)

The stock of domestic arrears is negatively associated with governance indicators

Sub-Saharan Africa: Selected Governance Indicators and Stock of Domestic Arrears, 2005–18

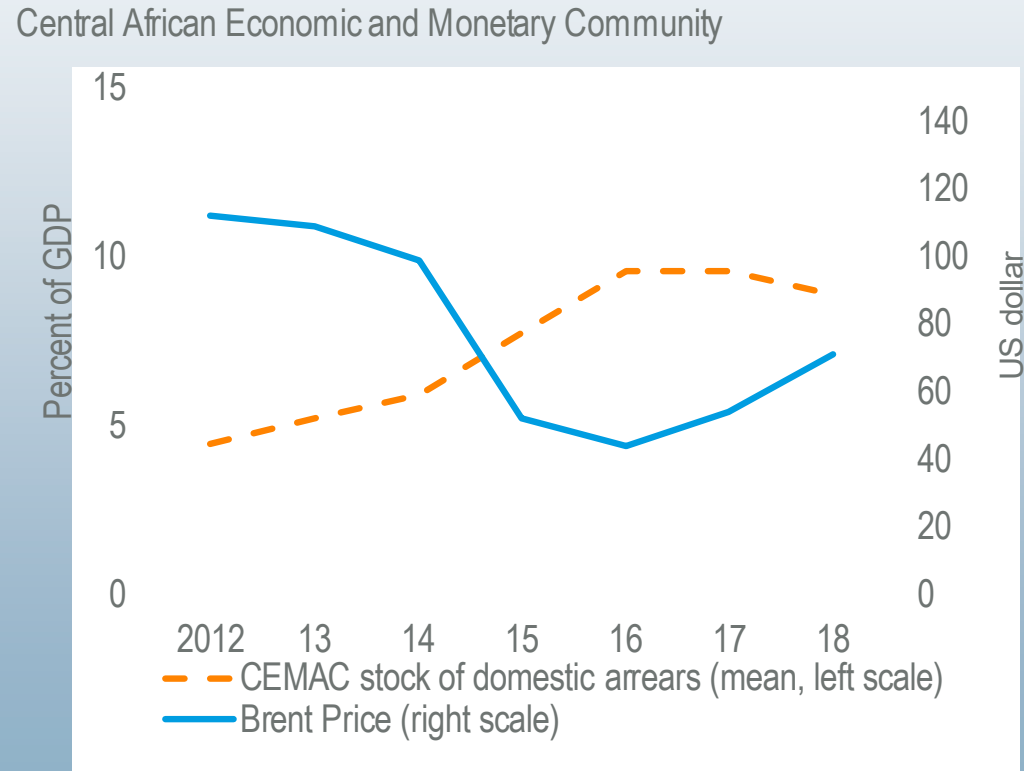
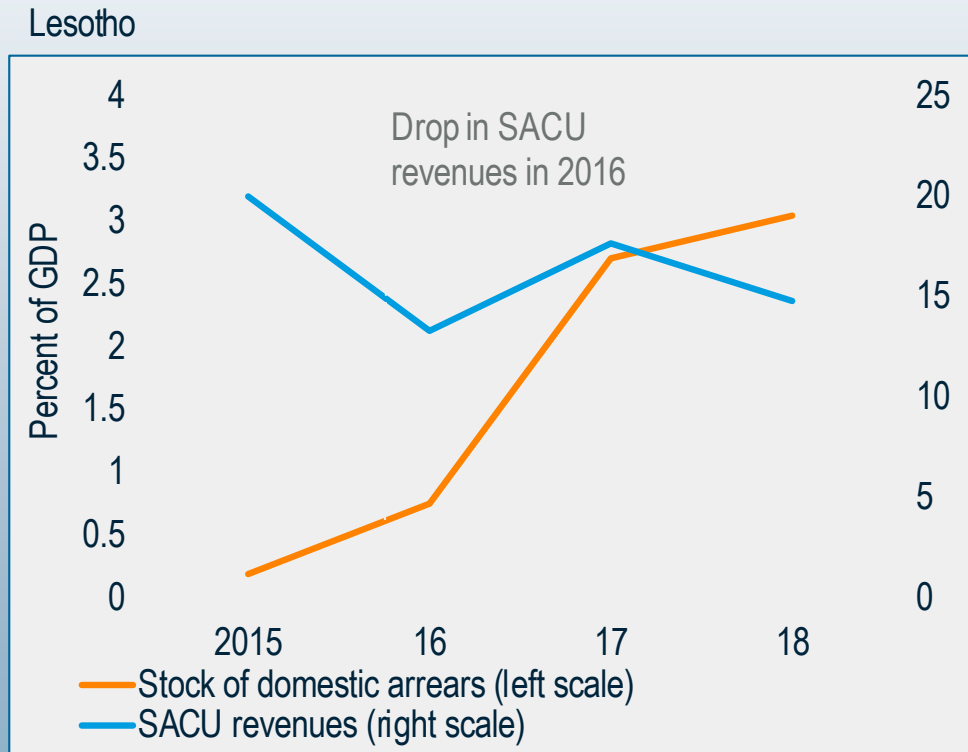


Sources: IMF staff calculations.



Causes of arrears accumulation (3)

Large domestic arrears accumulate following fiscal shocks



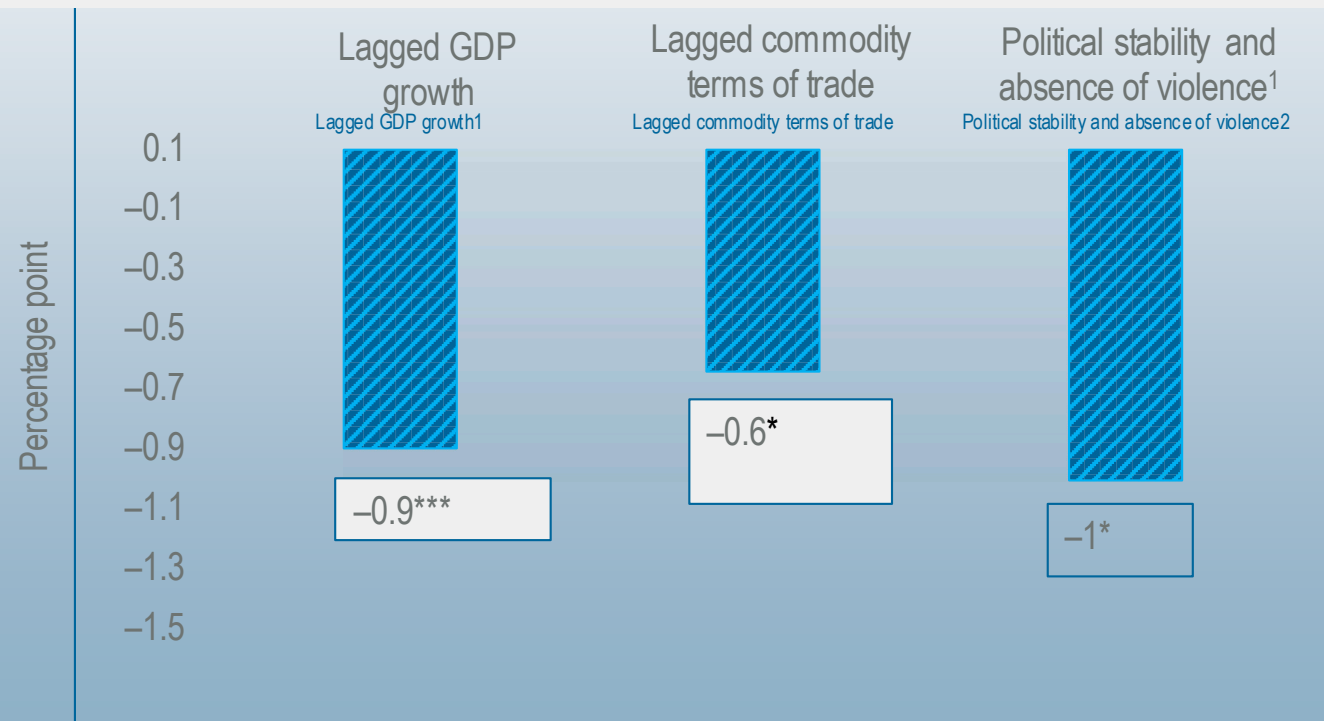
Sources: IMF staff calculations..



Causes of arrears accumulation (4)

Large domestic arrears accumulate following fiscal shocks

Causes of Domestic Arrears Accumulation: Regression Output



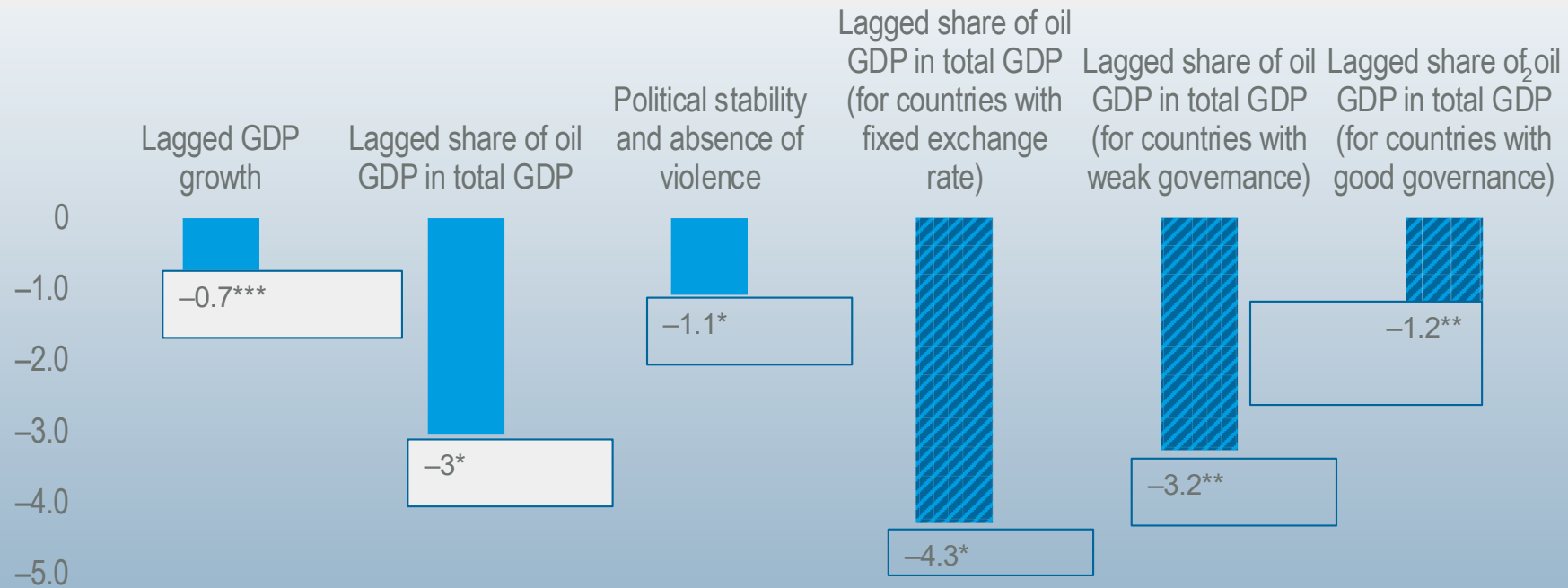
► Regression analysis indicates that lower growth, a decline in the commodity terms-of-trade, and political instability are associated with a larger stock of domestic arrears.

Sources: IMF staff calculations..



Causes of arrears accumulation (5)

Large domestic arrears accumulate following fiscal shocks



- ▶ Oil shocks seem to have a larger impact for:
 - ❖ countries under fixed exchange rate regimes
 - ❖ countries with weak indicators of governance

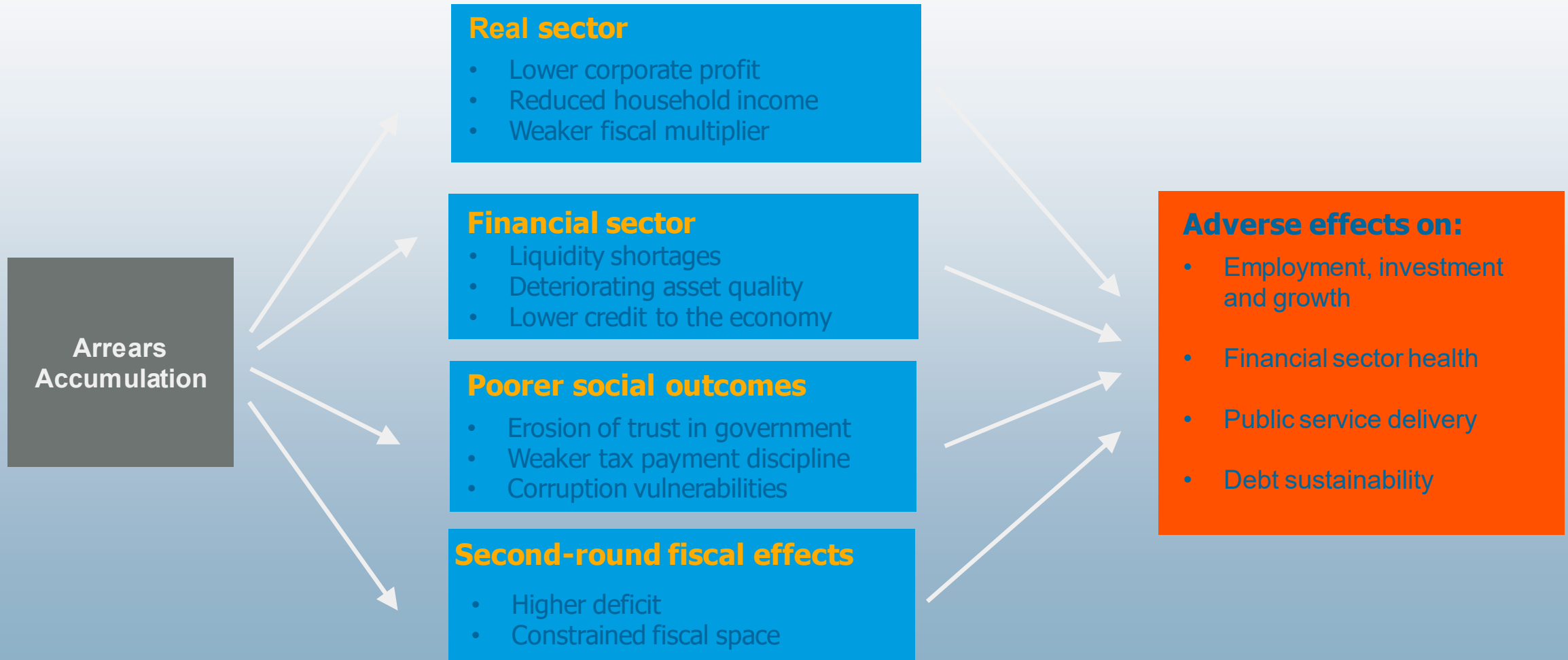
Sources: IMF staff calculations..

Roadmap

- Stock taking of domestic arrears in SSA
- ◆ Causes of domestic arrears accumulation
- ◆ **Macroeconomic effects of domestic arrears**
- ◆ Cures: clearance and prevention of domestic arrears



Macroeconomic impact of domestic arrears (1)

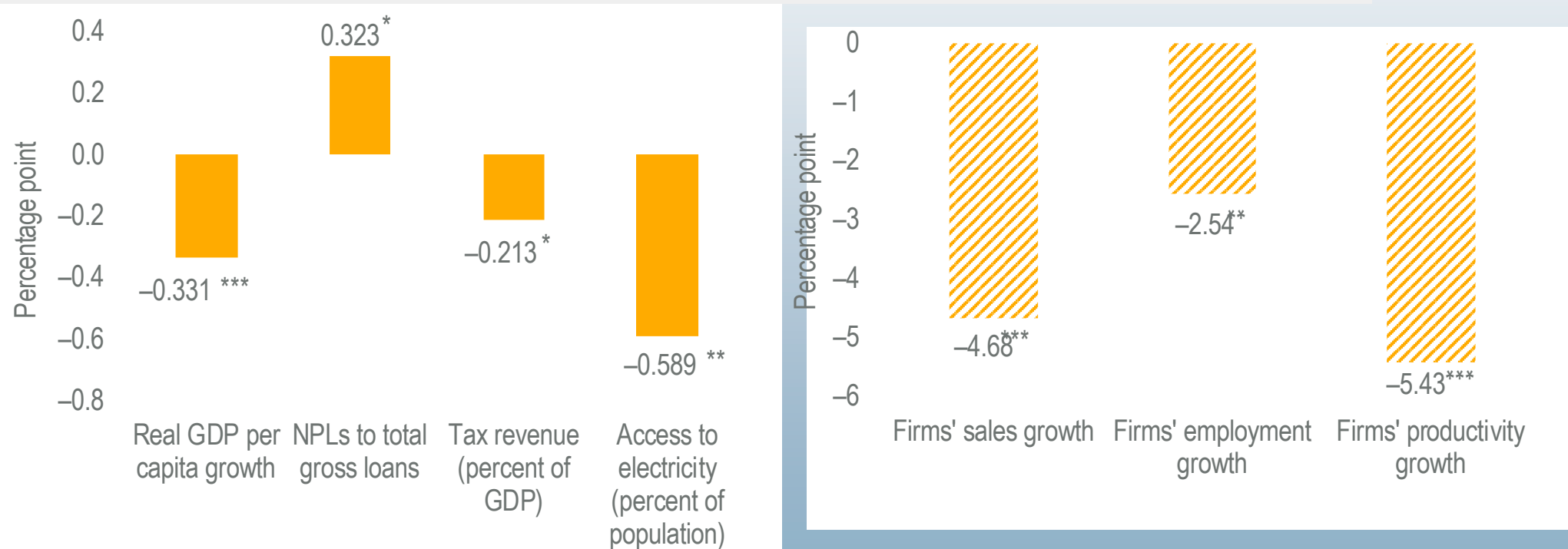




Macroeconomic impact of domestic arrears (2)

Domestic arrears undermine macro outcomes

Macroeconomic Impact of Domestic Payment Arrears: Regression Output



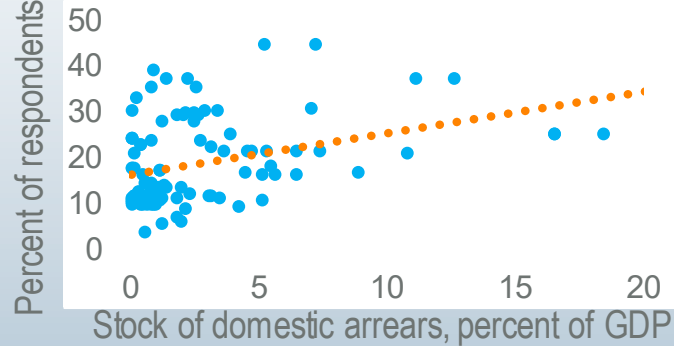
Sources: IMF African Department Desk Survey; Financial Soundness Indicators; World Bank Enterprise Surveys; World Development Indicators; World Economic Outlook database; and IMF staff calculations...



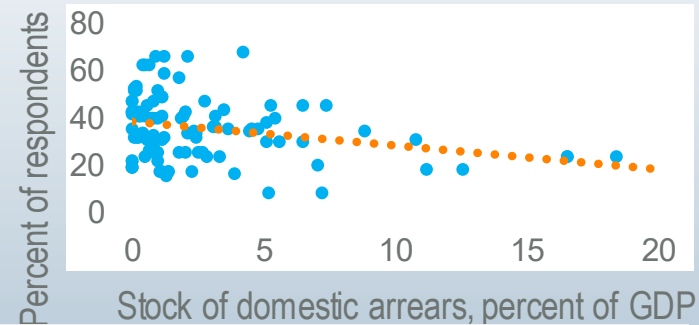
Macroeconomic impact of domestic arrears (3)

Higher levels of arrears are associated with lower citizens' trust

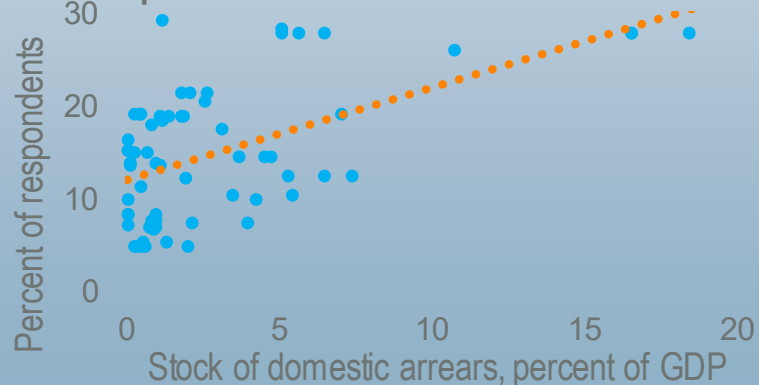
1. Trust in President/Prime Minister: Not at All



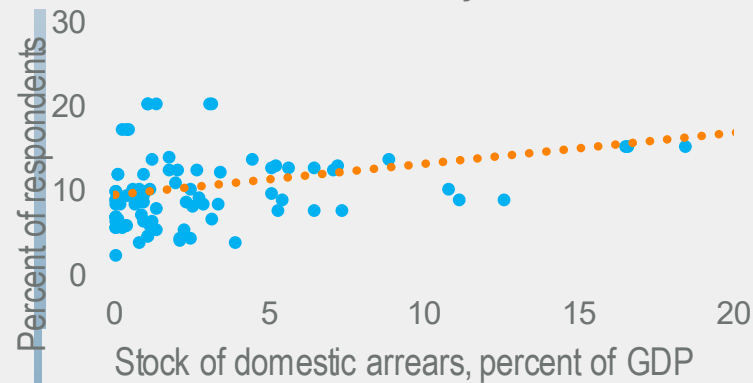
2. Governments' Management of the Economy: Very/Fairly Well



3. Corrupt Tax Officials: All of Them



4. Access to Medical Care: Very Difficult



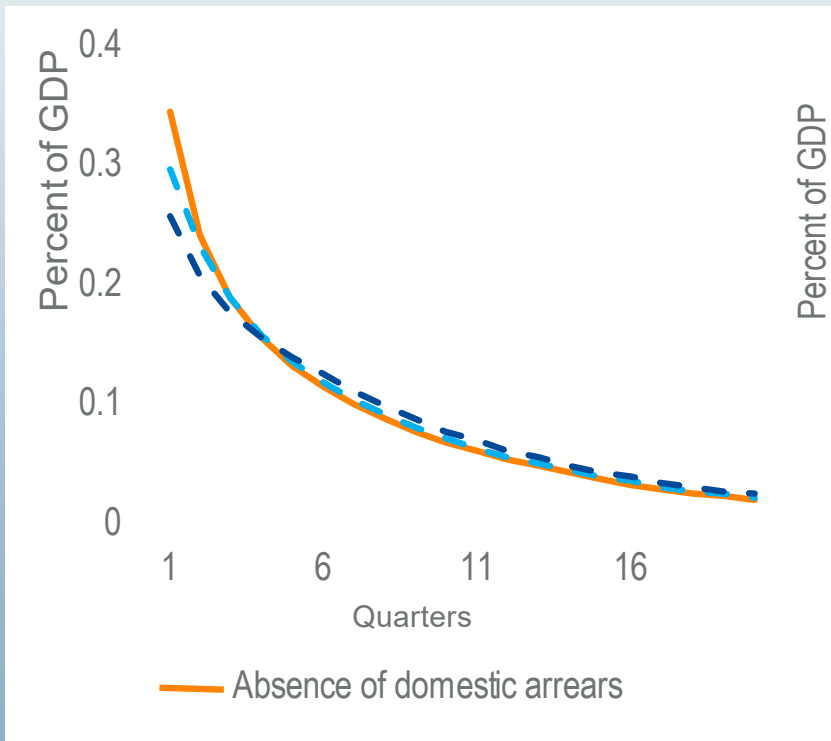
Sources: Afrobarometer; IMF African Department Desk Survey; and IMF staff calculations.



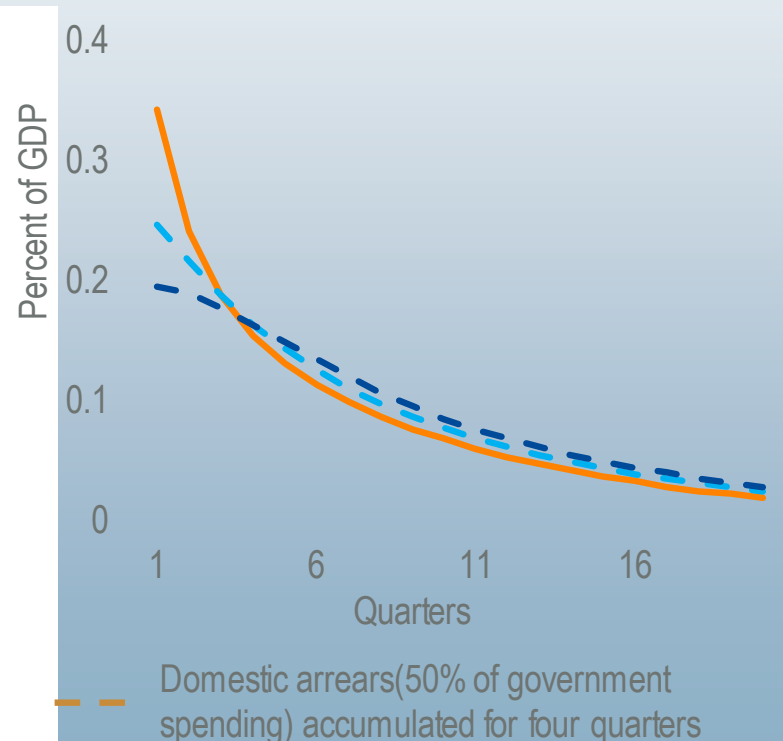
Macroeconomic impact of domestic arrears (4)

Domestic arrears reduce the fiscal multiplier

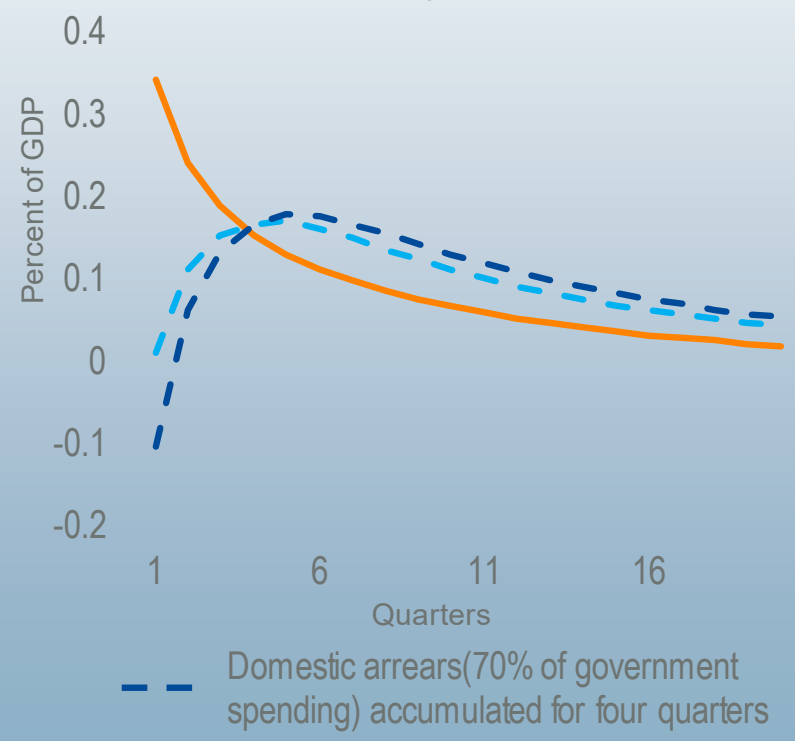
Fiscal multiplier in the presence of government domestic arrears



Fiscal multiplier in the presence of government domestic arrears and liquidity constrained private sector



Fiscal multiplier in the presence of large accumulation of domestic arrears and liquidity constrained private sector



Source: IMF staff calculations.

Roadmap

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- ◆ Causes of domestic arrears accumulation
- ◆ Macroeconomic effects of domestic arrears
- ◆ **Cures: clearance and prevention of domestic arrears**



Cures : clearance and prevention of arrears (1)

Essential elements of a clearance strategy

Guiding Principles

Full transparency to address governance concerns.

Prioritization guided by the impact on macro stability and inclusive growth.

Prevention requires a combination of PFM reform, sound fiscal policy, and political commitment.

Steps

Stocktaking and auditing of arrears

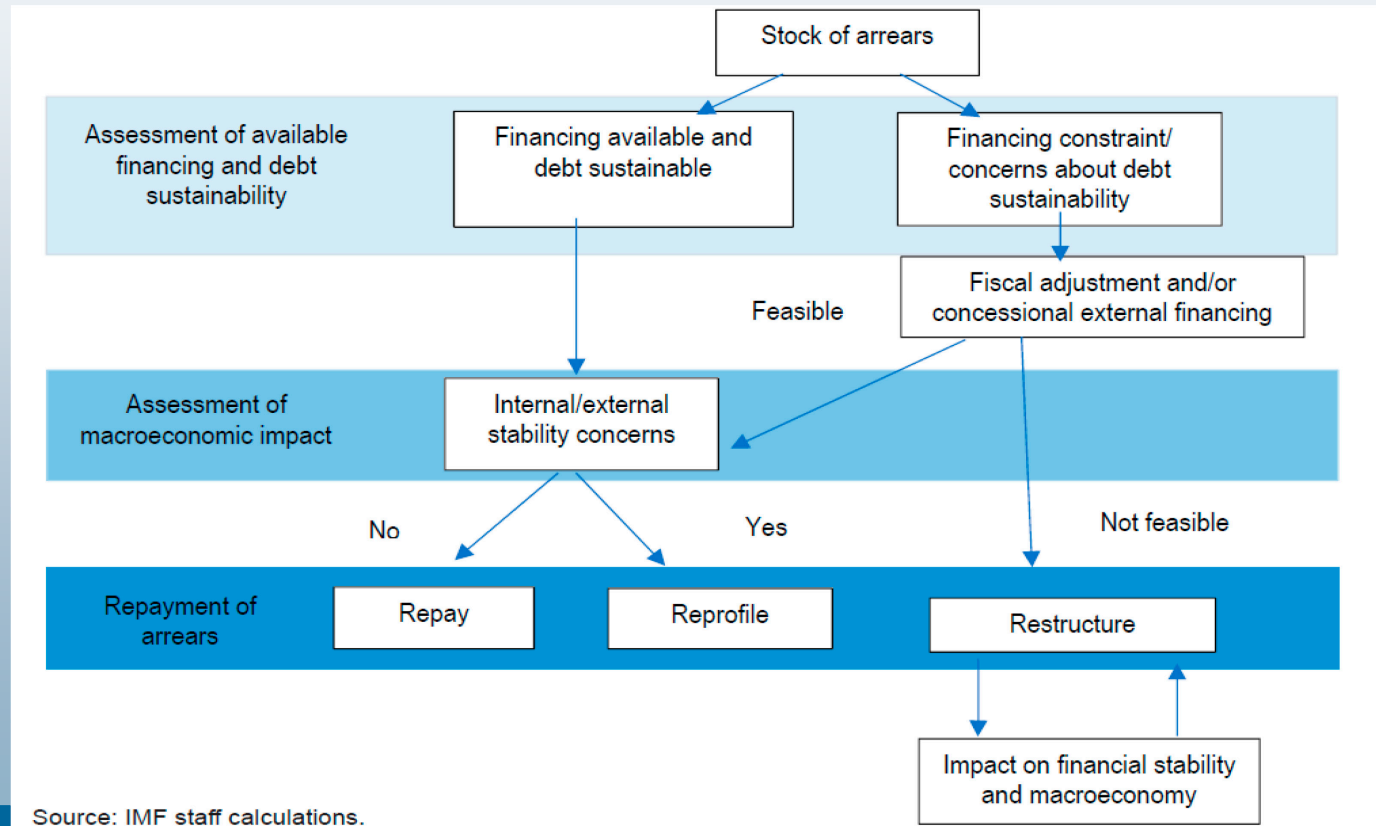
Development of a repayment strategy

Repayment



Cures : clearance and prevention of arrears (2)

Repaying Arrears – Stylized Decision Tree

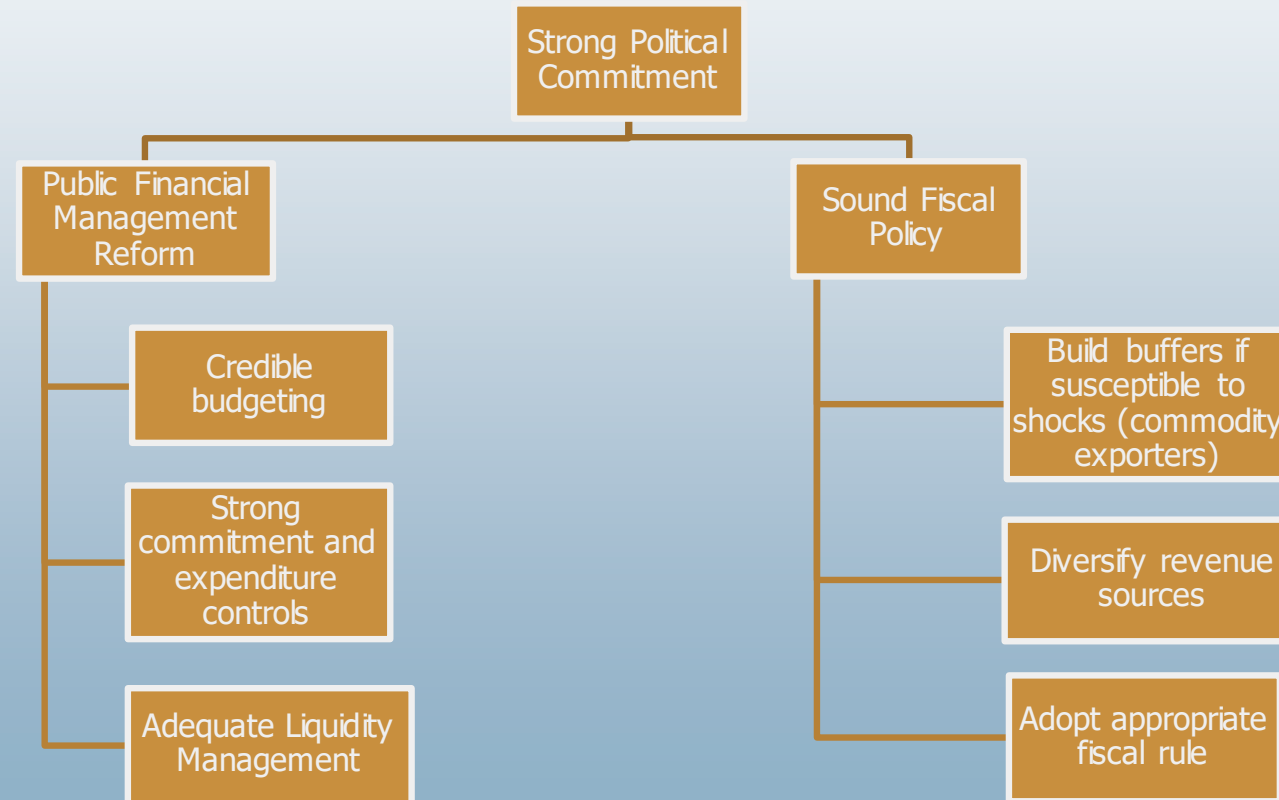


Source: IMF staff calculations.



Cures : clearance and prevention of arrears (3)

Preventing Arrears Accumulation





Key messages

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Arrears situation in Zimbabwe

- **Zimbabwe has protracted arrears on external debt for the past two decades**
 - ◆ There is currently no consensus on an agreed path forward to clear these arrears
- **On the domestic front, the situation is different**
 - ◆ All domestic arrears were essentially wiped out with the hyperinflation a decade ago. But despite this initial advantageous starting point, Zimbabwe is now in a similar position
 - ◆ Domestic arrears are overdue domestic payment obligations of the central government. These include obligations to domestic service providers, agricultural input suppliers, and domestic private sector contractors, but excludes government liabilities to other public sector units.
 - ◆ Inability to impose a hard budget constraint on say parastatals, or quasi-fiscal activities that are not budgeted for are major reasons for the arrears
 - ◆ The accumulation of arrears is especially pertinent at the local and central government level.



Way forward on Zimbabwe's arrears

● Better control on spending

- ◆ There is a need to better control on spending across government departments and ministries to avoid the accumulation of new arrears

● Honor commitments under the SMP

- ◆ The authorities have committed to not accumulate arrears noting that economic stabilization can be impaired by government arrears to its private-sector suppliers
- ◆ SMP Benchmark - complete a comprehensive stock-take of domestic expenditure arrears across the central government
- ◆ Strengthening the Public Finance Management System including sanctioning entities and individuals who spend without having received the authority will also be essential

● Political commitment especially on agriculture related expenditure

Thank You