Special Topic: Incorporating domestic arrears in the BoC-BoE sovereign default database

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From the inception of the BoC–BoE database in 2014, its coverage has been based on a broad definition of sovereign default—one that tracks both interruptions of scheduled debt service and changes in debt payment terms that result in creditor losses. For defaults involving private creditors, this includes marketable debt denominated in foreign and local currency. Still, other government fiscal actions suggest that the sovereign default perimeter should be extended further. Notably, there is substantial evidence that late payments by governments for goods and services—called domestic, fiscal or expenditure arrears—also create obligations to domestic creditors that are effectively in default and must ultimately be resolved.

Both the definition and the determination of domestic arrears are relatively straightforward, at least in theory (Flynn and Pessoa 2014). Arrears are generally defined as any overdue payments for legally mandated or contractually required expenditures, including pensions, salaries, other services and capital outlays. The time frame in which late payments become arrears is typically governed by local law—most often penalties and interest charges can accrue when payments are late by more than 30 or 90 days. When arrears accumulate over a number of years or their legality is disputed, governments and their creditors usually rely on domestic courts or ad hoc tribunals to reconcile and confirm claims before resolving them. Once finalized, these obligations are settled by some combination of cash payments and the issuance of new debt to creditors. Given the often extended time frame between when arrears emerge and when they are settled, it is clear that the domestic creditors involved incur material losses. Like conventional sovereign debt, however, outright repudiations of domestic arrears appear to be relatively rare.⁴

The clearance of arrears, and the adoption of polices to discourage them from recurring, are frequently objectives of the International Monetary Fund’s (IMF) country programs. This is

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⁴ Currency confiscations documented in the BoC-BoE database could be vehicles for at least partial repudiation of arrears.
not surprising, given the adverse impact that government arrears have on private sector activity in affected countries.\(^5\) But at the same time, IMF documents highlight that domestic arrears, like conventional sovereign defaults, often persist and recur. And like conventional defaults, arrears involve a broad spectrum of developing, emerging-market and (although less frequently) high-income sovereigns.

Until recently, the published IMF data on domestic arrears had limitations. The data reported usually identified flows of arrears, not stocks, based on government estimates subject to change. Moreover, since the IMF rarely reported estimated stocks of arrears, comparisons with the value of conventional sovereign debt in default were challenging. But IMF practice has changed: it now regularly reports domestic arrears data on a stock basis and explicitly incorporates them into the data on public debt. As a result, we can begin to compare data on arrears with the conventional defaults we currently report in the BoC–BoE sovereign default database.

Table 1 below highlights the 2018 domestic arrears data we compiled for 71 sovereigns from recent IMF Article IV and program documents.\(^6\) It includes the US-dollar value of stocks of arrears and their shares of each country’s gross domestic product (GDP) and public debt. In the 2020 BoC–BoE database, the new 2018 domestic arrears dataset is available in a separate tab, DOMARS, at the bottom of the downloadable spreadsheet. We plan to track arrears annually for each sovereign that incurs them in a new “domestic arrears” category of the database. We will also include arrears data we are able to gather for earlier years. With this wider coverage, we have two aims: first, to provide a more comprehensive picture of the scale of historical sovereign debt in distress; and, second, to evaluate whether domestic arrears are best viewed as a coincident indicator or as a driver of conventional sovereign defaults.


\(^6\) The relevant sources are included in the country listings in the appendix of the BoC–BoE Sovereign Default Database: Methodology, Assumptions and Sources.
Our main findings:

- In aggregate, the stock of identified fiscal arrears was sizable in 2018, amounting to US$152 billion, 3.7% of the group’s GDP and 5.8% its public debt.

- By comparison, global defaults on conventional debt in that year totalled US$396 billion. Excluding Greece’s exceptional reprofiling of its official debt, defaults amounted to US$285 billion.

- Consequently, identified arrears in 2018 were equivalent to 38% of all conventional debt then in default.

- Domestic arrears are correlated with conventional defaults: over half of the sovereigns in default in 2018 also had fiscal arrears.

- As a share of public debt, arrears ranged widely in 2018—from 0.1% (Argentina) to 62.2% (Iran).

The true scale of domestic arrears in 2018 was almost certainly higher globally, as the data does not cover all potential cases. For example, neither Lebanon nor Venezuela, where arrears in 2018 may have been, and could still be,
substantial, report them to the IMF. In Lebanon’s case, this may change if its request for a Fund programme proceeds; the story in Venezuela probably awaits resolution of its internal political stalemate.