AFRODAD

REVIEW AND ANALYSIS OF DEBT SUSTAINABILITY: GHANA

EXECUTIVE SUMMARY

This report seeks to highlight trends in key debt management measures for a selected number of African countries with debt management problems (Central African Republic, Chad, Ghana, Mozambique, Senegal and Zambia). Extra analysis on Ghana is presented. The question of whether certain African countries would be able to meet their debt obligations without resorting to default in the foreseeable future has been on the minds of many stakeholders. Public debt sustainability has become an issue recently because some countries who received aid under HIPC are again accumulating unsustainable debt. Between 1980 and 1995, that is before HIPC, the average growth rate was about 2 percent and rose to about 6 percent after HIPC (1996 to 2017) for the six selected countries. Proper debt management and debt relief partly account for better economic performance.

Based on the growth prospects, another round of borrowing has been intensified. The debt/GDP ratio and external debt service over exports ratio have been rising for this group of countries. Another worrying trend is the rise in interest payments on external debt. The share of concessional loans increased throughout the 1980s, 1990s and early 2000s to an average of about 76 percent in 2005 but has since been falling to an average of 47 percent in 2017. The implication is that these countries are increasingly borrowing from the open market instead of borrowing from traditional donors, who are known to insist on due diligence and prudent financial behaviour before disbursements are made. This serves as a check on sustainable debt accumulation.

After rebasing the economy of Ghana in 2013, the debt/GDP ratio fell from 73.9 percent in 2016 to 57.9 percent in 2018. Projections by the World Bank shows that the debt/GDP ratio would soon be higher than the benchmark of 56 percent for Ghana and higher than the 70 percent specified by the WAEMU. The consequence is that about 86 percent of interest and charges payments were made to commercial sources in 2017, while only 6 percent and 8 percent were paid to bilateral and multilateral sources respectively. The MOFEP has budgeted to pay about 88 percent to commercial sources in 2018. Another observation is that the share of the domestic debt owed to the local banking system has fallen from 52.5 percent in 2014 to 35.4 percent in 2017. The share of the foreign sector increased from 17.1 percent in 2014 to 38.4 percent in 2017, but down to 30 percent in 2018. This makes the public finance venerable to exchange rate shocks when investors decide to take their funds out of the economy.

What makes the situation more disturbing is the relatively lower revenue mobilization in Ghana as compared to countries in SSA. Projections for external debt service to revenue for Ghana from 2017 to 2022 are far above the threshold of 20 percent. From around 20 percent in 2005, debt service has been above 40 percent of domestic revenue for 2016 and 2017. Interest payments constituted 45 percent of tax revenue in 2016 for Ghana. This seriously affects funds available for capital expenditure and other important expenditures.

Growth prospects for Ghana appear good. The real GDP growth for 2017 was 8.1 percent, from 3.4 percent in 2016. Provisional estimates for 2018 show a growth rate of 6.3 percent. Fiscal deficit improved from 6.5 percent in 2016 to 4.8 percent in 2017. Interest rates on domestic government securities have fallen because of debt restructuring. The fiscal deficit is planned to have been capped at 5 percent of GDP. The oversubscription of Ghana's Eurobond sales on the international market appears to have worsened the overconfidence of the executive. Borrowing continues even though the public debt in Ghana is exposed to exchange rates risk. Expenditures appear more than warranted and likely to worsen the debt problem.

To throw more light on the loan contraction process, a loan of 13 million euros that has been contracted to establish a deposit insurance scheme based on international best practice is reviewed. The objective is to reduce government contingency payments in the event of a bank failure and increase trust in the banking system. The loan was approved by Cabinet around late 2017 and by parliament in early 2018. Thus, the contraction process involved the right institutions in Ghana.

A description of the loans contracted in 2017 and 2018 is provided in this report. A total of 10 external loans were contracted in 2017 and 24 in 2018. About 77.9 percent of the loans in 2017 was non-concessionary and 19.7 percent was concessionary, in addition to a 2.4 percent domestic standard loans. Non-concessionary loans in 2018 represented about 87 percent. The interest rates and rates for other charges are lower for concessionary than for non-concessionary loans. More than half of the loans were contracted from the World Bank. About a quarter of the loan amount in 2017 and 2018 went to the Ministry of Roads and Highways and the Ministry of Transport. About one-fifth of the total amount of loans financed projects by the Ministry of Finance and about 15 percent went to the Ministry of Education.

For sustainability reasons and given the current low domestic tax revenue mobilization, the executive should consider scaling back public expenditures and creating the conditions for the private sector to increase production to avoid a reduction in the growth of the economy. The monitoring capacity of public officials should be improved to monitor public projects. Traditional development partners still need to be engaged to maximize concessional loans as much as possible. More efforts should be made to increase domestic revenue mobilization by streamlining processes and encouraging more digitization of public services. Regular progress reports on public projects should be demanded by parliament. Civil society organisations should ignite discussions on the dangers of pursuing commercial loans and engage the executive about the dangers of over-borrowing.

Contents

LIST OF FIGURES

ACRONYMS

BoG	Bank of Ghana

CAR	Central African Republic
CPIA	Country Policy and Institutions Assessment
DIS	Deposit Insurance Scheme
DSA	Debt Sustainability Analysis
GDP	Gross Domestic Product
GDPC	Ghana Deposit Protection Corporation
HIPC	Heavily Indebted Poor Country
IADA	International Association of Deposit Insurers
MDRI	Multilateral Debt Relief Initiative
MOFEP	Ministry of Finance and Economic Planning
ODA	Official Development Assistance
SSA	sub-Saharan Africa
IMF	International Monetary Fund
UNDP	United Nations Development Program
USD	United States Dollars
WAEMU	West African Economic and Monetary Union
WDI	World Development Indicators

Section One: Introduction

Government borrowing to finance expenditure has been a regular feature of sovereign economic management, especially in sub-Saharan Africa for the past four decades. There are numerous reasons for borrowing by a government apart from the usual need to finance essential expenditures. There should be no alarm if policy makers decide to borrow both domestically and from foreign sources to support the budget. The extent of such borrowing is the bone of contention. It is uncontroversial to say that most economic decisions have their merits and demerits. Generally, there is less controversy about the merits of public sector borrowing. One main merit is to smoothen expenditure or government consumption, which in some countries, constitute a significant part of the aggregate economy. Financing budget deficits from debt in a recession or other economic crisis could encourage economic growth.

But too much of a good thing is bound to create problems. Uncontrolled and unbridled public sector borrowing fuels public debt. When the public sector debt keeps growing, cost and risks intensify. In such cases, the perceived benefits are bound to be outweighed by the cost, which comes in various forms. One big risk is that the meager revenues collected are used to service debt instead of expenditure on vital sectors like education, health and critical infrastructure. Polices to reduce public sector debt may be painful, but holds the promise that the pain or reduced output may be milder as compared to the cost and risks associated with ever-growing debt (Best et al., 2018). This is the guiding principle of this report on debt sustainability for a selected number of African countries, especially Ghana. It is believed that debt restructuring and management should not wait until a full-blown crisis ensues.

The main objective of this report is to describe key measures that highlight the nature of the debt problem in a selected number of African countries with debt management problems. More light is shed on the situation in Ghana, a description of the measures or debt ratios that show the extent of the debt situation in Ghana. A description of the loans contracted in 2017 and 2018 is presented. A case of a particular loan contracted by the Ghanaian authorities is selected and analysed. A few terms or details of the project, the process and institutional backing and justification for the project to be financed by the loan are described.

This report is timely as a lot is being published on debt sustainability by various international agencies and institutions. Reports on debt suitability analysis for specific countries have been published by the IMF and it is still ongoing for more countries. Debt sustainability is currently topical for countries in sub-Saharan Africa because for low-income countries in the region about 40 percent of them are now described as either in debt distress or have a high risk of debt distress (IMF, 2018a). Some countries contract loans to pay off or restructure existing loans (for example Ghana). The main reasons accounting for this are perpetual fiscal deficits, low savings rate and exchange rate depreciation. Continuous exchange rate depreciations stem from falling commodity prices and relative over-reliance on foreign loans as compared to countries from other regions.

The available published studies on debt do not focus on the process of contracting loans and the extent to which the process follows due diligence and institutional provisions and procedures. This is relevant because loans are contracted usually with little involvement or consultation of the citizens or taxpayers who end up paying such loans at considerable cost. Of course, ordinary individuals in an economy may not have the right incentives and ability to demand transparency from loan contracting agents. But civil society organisations can demand such transparency to put pressure on policy makers to ensure sustainable practices and value for money for any loan.

Activities of civil society organisations can reduce incentives for contracting and hiding loans that are bound to be revealed. A second reason for the need for civil society organizations to get involved is that government officials sometimes dislike the stigma associated with borrowing from institutions like the IMF and World Bank because of restrictive terms or conditionality and borrow from the open market which is associated with increased cost and risk (IMF, 2009). Civil society organizations can aim to encourage politicians to be mindful of their borrowing habit and lower their urge to borrow from commercial sources.

After the introduction in section one, section two would present the theory and a literature review on debt sustainability. This would be followed by section three on the methodology of the study, data sources and a discussion of debt sustainability issues for six selected African countries. Section four presents more on the debt sustainability issues for Ghana to explain why Ghana is now at high risk of debt distress, using the general debt burden, the composition of the debt and the exchange rate risk. Evidence is provided for overconfidence on debt in Ghana and the Eurobond issues. The loan contraction process of one concessional loan for the establishment of a deposit insurance scheme in Ghana is discussed. The report will conclude with a section on conclusions and recommendations.

Section Two: Theory and Literature Review on Debt Sustainability

Public debt sustainability is related to the solvency of a government. A crucial question is: would the public purse be able to meet debt obligations without resorting to default in the foreseeable future? Future events are difficult to correctly predict. An exercise to calculate the present value of all future flows and assets of a government would be full of assumptions that are difficult to defend. These reasons make the analysis of government solvency difficult. Unforeseen disturbances can make a smooth-running government go bust and in some cases making it beneficial on net basis to default (Debrun et al., 2018). Public debt analysts focus on debt sustainability instead, but yet still a strict definition is difficult. One reason that makes public debt analysis difficult is the definition of public debt to adopt, which is the kind of liabilities to include in measuring what citizens of a nation owe to people of other nations or to themselves. How to value the debt and even the name to give the measure may have various implications: "sovereign debt, public debt, national debt or government debt" (Arsanalp et al. 2018). Another complication is that econometric analyses cannot be used to answer all the important questions on debt sustainability (Debrun et al, 2018). The difficulty of debt sustainability analysis should not discourage national and international agencies from carrying it out because it can provide a clear warning signal far before a crisis.

It is important to note that public debt plays a major role in any economy, especially in the financial sector. Jonasson et al. (2018) describe roles like being a source of a benchmark for evaluating yields on corporate debt, serving as a tool for liquidity management for a country's central bank and helping to develop market infrastructures like the legal framework and efficient payment system. One key role for government debt also described by the authors is that it serves as a near-zero risk investment option for investors and fund managers whose key objective is the security of their investment. This partly explains why Ghana's Eurobond issue in March 2019 was over-subscribed seven times and a negative yield on a German 10-year government bond issue in 2019[1].

The nature and type of debt differ between countries. Even a set of advanced economies could have huge variances in the ratio of public debt to GDP. Two advanced countries compared in the literature are Germany and Japan (Debrun et al., 2018). Japan has a huge debt to GDP ratio of more than 200 percent and most of the debt is held by the Japanese central bank and other financial establishments, but that of Germany is around 60 percent[2]. The strength of these two economies is unquestionable.

Fatas et al. explain that government borrowing is not always for good reasons and can be higher than socially optimal levels for political economic reasons. They explain bad reasons like over borrowing to manipulate successive governments, a bias towards current consumption which encourages pilling up debt to be paid by future generations to compensate for the building of certain infrastructures. Other reasons are rent-seeking behaviours and the common pool problem where certain groups benefit more from certain projects and would lobby for borrowing to finance such projects even though the cost born by the greater number of people to repay the loan would exceed the benefit enjoyed by the smaller group. Civil society organisations could demand more information on project loans and disseminate them so that voters would make informed choices. Knowing that politicians sometimes borrow for wrong reasons, activities of civil society organisations could serve as a check so as to move closer to debt sustainability.

It is uncontroversial to suspect that heavy debt burden can adversely affect economic growth currently and for later periods (Ostry, Ghosh, and Espinoza, 2015). The effect of debt on growth would depend on the nature and structure of public debt. A review by Fatás et al. (2018) shows that even though a negative relationship between public debt and later economic growth has been observed, it is difficult to prove causality between the two measures. This is because the loans were used for different types of projects, has different terms and payment options and different lenders. There are also so many unobserved factors behind a country with low growth which could be causing both the low growth and debt accumulation. To sum, not all debt are the same and must have different effects on various aspects of an economy.

For HIPC countries in Africa, there are various challenges that constrain attempt to restore debt sustainability. A review by Rustomjee (2017) shed light on significant challenges like declining GDP growth, falling commodity prices and deteriorating terms of trade. Other challenges are falling share of multilateral debt in total debt as a result of borrowing from external private capital sources, rising interest rates leading to declining growth interest rate differential and insufficient primary fiscal balances needed to move closer to debt sustainability. The infrastructure gap in Africa is a strong reason why African countries are tapping commercial loans because traditional concessional loans have been found to be inadequate or not sufficient

[1] "Germany's 10-year government bond yields slipped into negative territory on Friday for the first time since October 2016". https://www.cnbc.com/2019/03/22/german-10-year-bond-yield-turns-negative-for-the-first-time-since-october-2016.html

[2] The IMF Debt data in Stata format report the General government debt (% of GDP) for Germany as 63.85% and for Japan as 237.65% in 2017. Accessed on 18th April 2019.

(Nissanke, 2013). Concerns have been raised about loans from China especially, because of transparency issues as the Chinese government hardly give out official statistics on loans, export credits or ODA (Brautigam and Hwang, 2018). A full literature review of public debt is too broad to exhaust here. We now turn to debt sustainability measures for six countries in Africa.

Section Three-Debt Sustainability Issues for Six African Countries

3.1 Methodology and Data Sources

The analysis in this report is mostly descriptive and would involve both quantitative and qualitative discussions. The trends of key debt sustainability measures would be discussed for a selected number of six African countries. More analysis would be done on the case of Ghana. The descriptive analysis will mimic the debt sustainability approaches of the IMF and World Bank which focus on the extent to which projections deviate from debt ratio thresholds for particular countries (Ncube and Brixiova, 2014). The DSA of these two institutions is interesting because the investigation is forward-looking and focus on the trend of relevant debt-burden ratios over the next two decades (Nissanke, 2013)[3]. The idea is to prevent, rather than cure a debt crisis.

Secondary data is the main source for the analysis of the quantitative measures. Quantitative data from the IMF debt statistics, the World Bank, MOFEP (budgets statements for 2018 and 2019 especially, the 2017 and 2018 Annual Debt Report) and the BoG (Monetary reports) are used in this report. Qualitative data from interviews on a selected concessional loan is also analysed.

3.2 Debt sustainability issues six Africa countries

The following discussion focuses on debt sustainability issues and trends for six selected countries in Africa which had been described as either in debt distress or high risk of debt distress in 2017 (Central African Republic (C.A.R.), Chad, Ghana, Mozambique, Senegal and Zambia)[4]. At high risk means that “one or more debt burden indicators breach the thresholds on a protracted basis under the baseline scenario” (Nissanke, 2013, 22). Those in debt distress are having difficulties honouring their debt obligations. From the total of 36 countries that have been given debt relief under HIPC (starting from 1996) and MDRI, 30 are from Africa (Eichengreen et al. 2018). This was done to save the countries from the adverse consequences of debt over-burden and prevent a crisis. As a result, fiscal management and economic growth followed from the lower extent of indebtedness in the years just after the debt relief (Battaile, Hernández and Norambuena, 2015). The IMF Regional Economic Outlook for sub-Saharan Africa for 2018 reports that about 40 percent of low-income countries in the region are either already in debt distress or at high risk of debt distress. This has resulted from an increased pace of debt accumulation.

[3] A critique of the DSA is provided by Nissanke (2013).
[4] Mozambique is in debt distressed from the year 2017 and still in 2019. Chad, C.A.R., Ghana and Zambia are at high risk of debt distress. Senegal is described in 2019 as having a low risk of debt distress (IMF, 2019).

Three aspects of the recent pattern of borrowing by African countries have exposed them to higher risks and been a cause for concern. These have been explained by Mustapha and Prizzon (2018). After reporting that 18 and 8 countries are at high risk of debt and in debt distress respectively, the first aspect is the decreasing share of multilateral loans in total external debt. This should be a problem since such loans are given at concessional terms as compared to open market loans. The second aspect is the increasing share of loans from countries like China for huge infrastructural projects with less transparency. A third aspect is the pace at which some African countries are selling bonds on the international market to acquire huge amounts in short periods. The market seems to have faith in their economic performance.

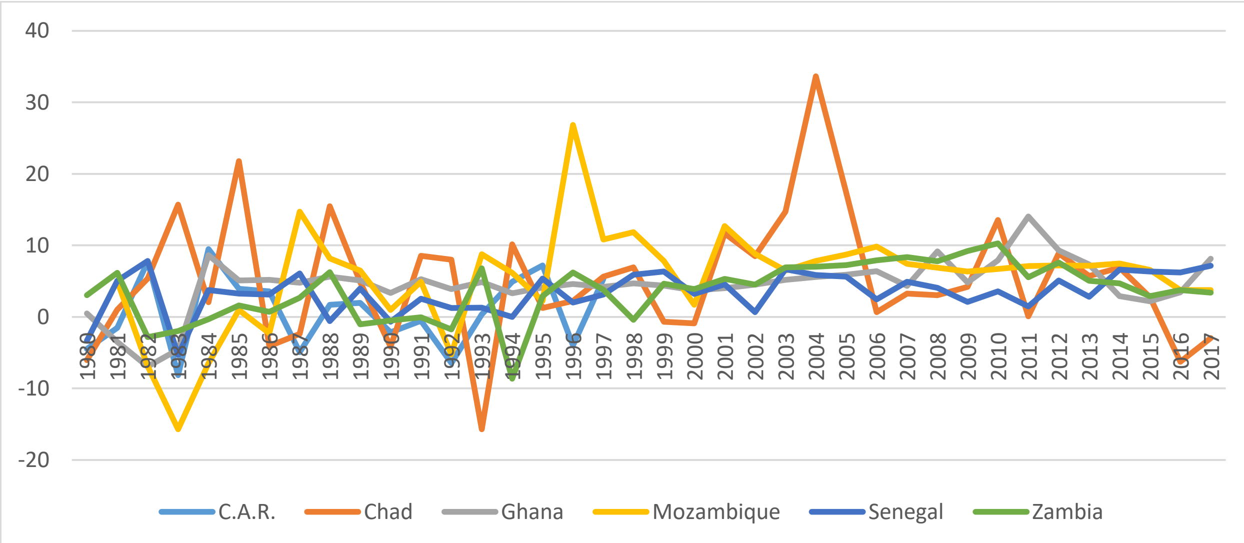
The trend of the annual rate of real GDP growth for the six selected countries in Africa, which have all benefited from HIPC and MDRI is plotted in Figure 1 from 1980 to 2017 using figures from WDI indicators. Before the HIPC (1980 to 1995), the average growth rate for the six countries is under 2 percent (1.98%). But after HIPC (1996 to 2017), the average growth rate is about 6 percent. Even though Chad has experienced negative growth rates for 2016 and 2017 (which could be related to debt distress and conflict), the average annual growth rate for 1980 to 1995 is 3.9 percent as compared to 6.3 percent after HIPC (1996 to 2017). Chad, an oil exporter, has experienced huge swings in annual GDP growth rates as compared to the other five countries. Thus, we can conclude that these countries have performed better after HIPC than before, partly due to proper debt management and debt relief.

But there is evidence to show that the gains are at risk again because of increased borrowing even though four of the countries are enjoying stable growth of almost six percent on average in the last decade. For the growth of per capita GDP in the last decade, the average for the six countries is about 1.8 percent. Excluding CAR which has a huge negative spike in 2013 of -36 percent (Figure 2), the average growth rate of GDP per capita is about 2.5 percent. When compared to the average growth rate of per capita GDP for sub-Saharan Africa of 1.1 percent for the last decade, the six selected countries did better.

A discussion of the current trends in debt ratio measures that have been used to gauge debt sustainability in the IMF's Debt Sustainability Analysis (DSA) for the selected six African countries follows. The DSA measures gauge the extent to which government debt can be repaid without resorting to debt relief or a huge reduction in expenditure to service the debt (World Bank, 2006). The ratio of debt to GDP is one of the measures that show the extent to which an economy can withstand shocks emanating from its debt obligations (Baduel and Price, 2012). For the six selected countries, in Africa, Figure 3, shows the pattern of Central government debt as a percentage of GDP. The central government debt includes both domestic and external borrowing.

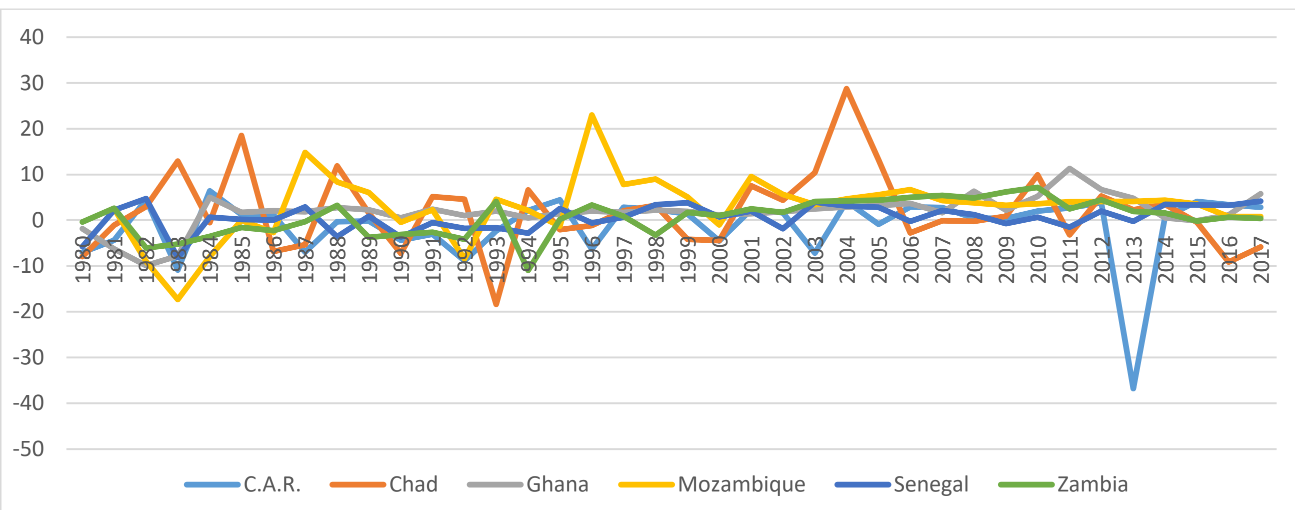
Before HIPC in 1996, the graph shows wide variations in the debt/GDP ratio between the countries with almost all the countries experiencing gradual increases. A clear spike can be seen around 1994, after which the ratios fell until 1998 and further increased around the year 2000. A conspicuous spike in the ratio for Zambia occurred in the year 2000, after that a gradual decline set in. The decline happened for all the countries, partly because of debt relief from HIPC. Between the year 2006 and 2012, the percentage stayed below 50 percent for the six countries.

Figure 1: Annual GDP growth rate for the six selected HIPC countries (percent)



Source: Using data from the WDI

Figure 2: Annual GDP per capita growth rate for the six selected HIPC countries (percent)

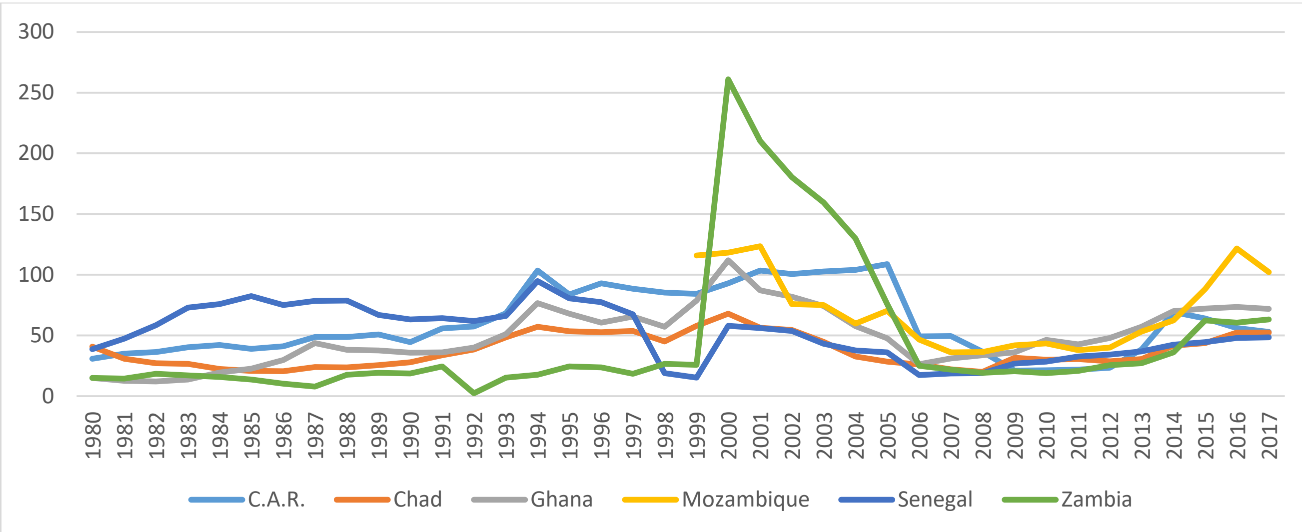


Source: Using data from the WDI

Improvements in the countries' debt sustainability measures and growth prospects encouraged another round of borrowing. For this group of countries, we observe a clear rise in the debt ratio for each country with a sharp spike for Mozambique in 2016 to above 100 percent (121%). This may be related to the "tuna bonds" sold in 2013 which later forced the government to announce a default in January 2017 (Debrun et al. 2018). What is uncontroversial is the observation that the debt/GDP ratio has been rising for all these countries which had enjoyed debt relief under HIPC.

A high value of the debt/GDP ratio alone may not necessarily spell doom, bearing in mind a relatively huge ratio for Japan (above 200%). The characteristics of the debt may differ and a relatively low debt ratio could even cause default risk like the example of Ukraine.

Figure 3: Central government debt as a percentage of GDP for six African countries (1980 to 2016)



Source: Using data from IMF debt data in Stata format. Accessed on 18th April 2019[5].

Debt service to exports ratio is another measure of debt sustainability used in the DSA. The measure of debt service used here is on external debt. External debt service is the sum of annual payments for the principal and interest on external loans that are owed to nonresidents. This is important because of the increase in foreign currency debt in sub-Saharan African countries and exports are the main source of foreign currency that could be used to pay for such debt (IMF 2018a). The current values in USD for external debt service and exports were used to compute the ratio and percentages using data from the World Development Indicators (WDI).

Figure 4 shows the trend in the percentage of external debt service in exports for the six African countries for the period 1996 to 2017. From

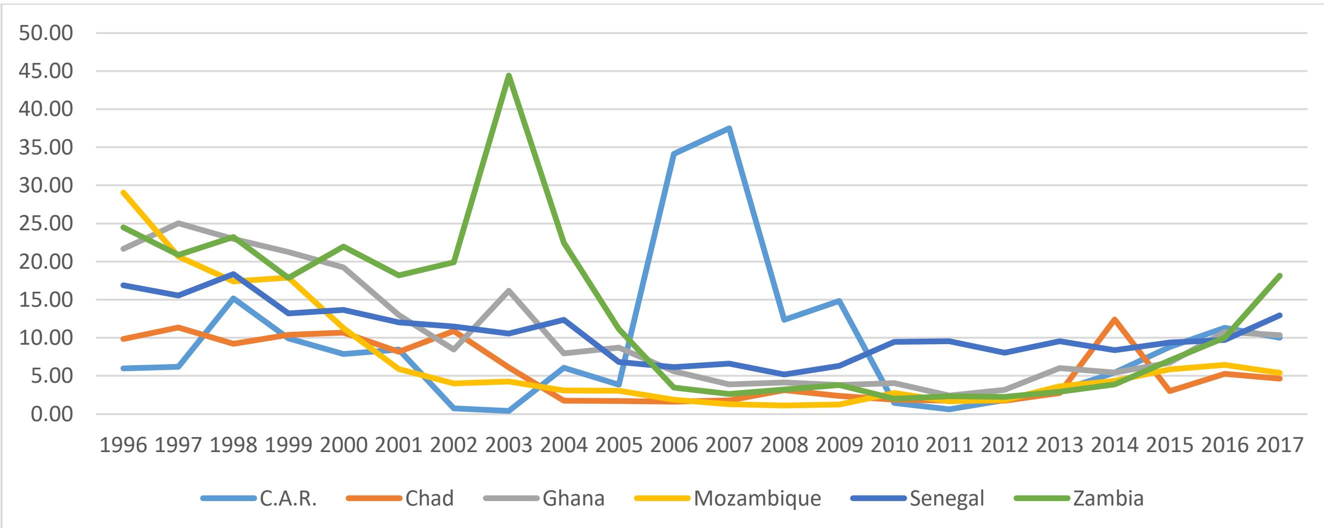
Figure 4, before 2010, the percentages varied between the countries and was very unstable than after 2010. Huge jumps were observed for Zambia in 2003 to more than 40 percent and for Senegal to about 35 percent in 2007. The percentages fell gradually for each country to below 10 percent in 2015 which is half of the threshold of 20 percent reported for Ghana in a DSA by the IMF (IMF 2018b). That was welcome news, but just after that, the percentages began to rise again. The value for Zambia is above 18 percent in 2017. Thus, just as debt/GDP ratio is rising for this group of countries, external debt service/exports ratio has also begun to rise.

A similar picture is seen from a plot of the interest payments on external debt as a percentage of exports as reported in the WDI data set. Between 2004 and 2015, for all the six countries, the value was less than 5 percent and stable during the whole period (Figure 5). Before that period,

[5] Variable name: cg. Label: Central government debt, % of GDP

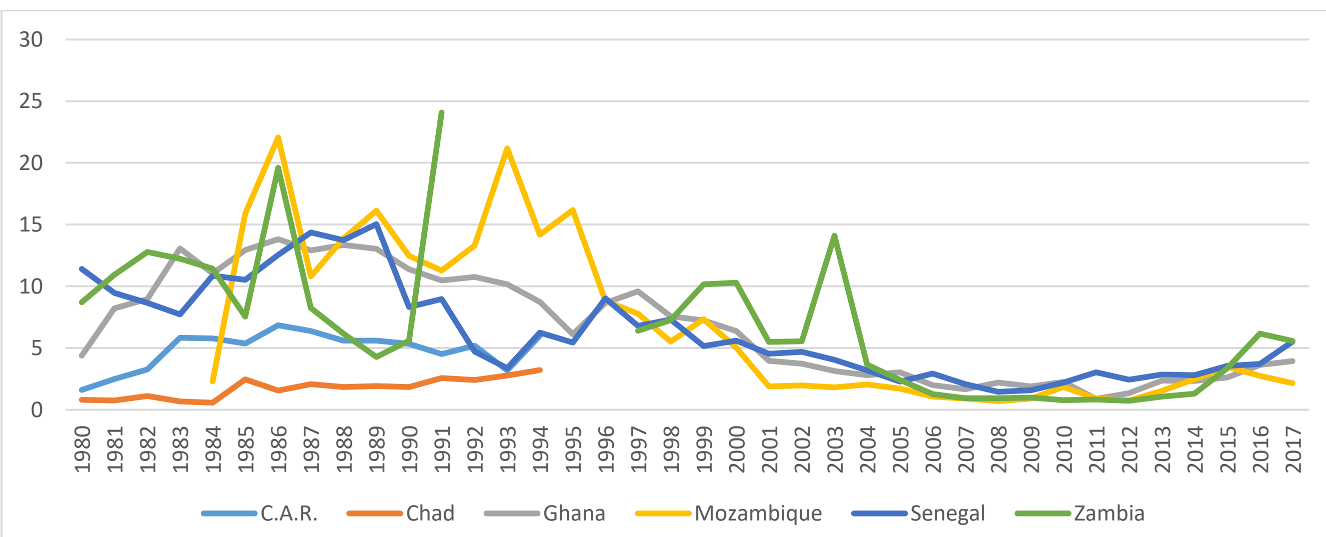
there were wide swings for various countries, with Zambia and Mozambique having relatively high percentages. After 2016, the figures show rising percentages for Ghana, Senegal and Zambia. In line with rising total external debt service/exports ratio, interest payments on external debt have also been rising for this group of African countries and probably for other African countries borrowing from external sources.

Figure 4: Debt service on external debt over exports after HPIC-1996 to 2017 for six African countries (percent)



Source: Using data from WDI: Debt service on external debt/ Exports of goods and services[6]

Figure 5: Interest payments on external debt (% of exports of goods, services and primary income)-IMF/WDI, percent



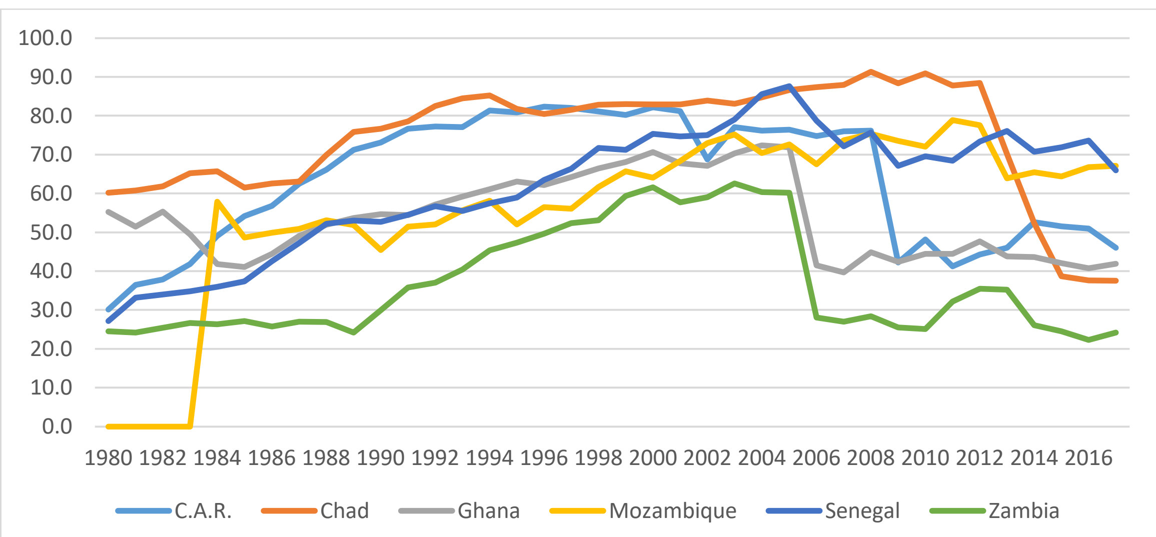
[6] (Debt service on external debt, total (TDS, current US$)/ Exports of goods and services (current US$))*100

Source: Using data from WDI: Interest payments on external debt (% of exports of goods, services and primary income)

An important measure of debt sustainability for developing countries is the share of concessional loans in total loans. The terms of bilateral and multilateral loans are easier for developing countries to bear as compared to commercial loans. For this group of six countries, the share of concessional loans increased throughout the 1980s, 1990s and early 2000s to an average of about 76 percent in 2005 (Figure 6). The share started to fall around those years with each country experiencing reductions in different years. The fall started for Ghana (from about 72 percent in 2005 to 42 percent in 2006, further down to 41.9 percent in 2017) and Zambia (60 percent in 2005 to 28 percent in 2006). Concessional loans to the Central African Republic were the next to fall (from 76% in 2008 to 42% in 2009 and 46% in 2017).

Mozambique still enjoys a relatively high percentage of concessional loans (77.6% in 2012 but fell to 67% in 2017). Chad experienced a very drastic fall in the share of concessional loans from 70 percent in 2013 to 52 percent in 2014 and further down to 37.5 in 2017. Thus, it is obvious that, for this group of countries with debt sustainability problems, the share of concessional loans has fallen in recent years to an average of 47 percent in 2017. This means the countries are increasingly borrowing from the open market. The implication is that the contribution of the low real interest rates to reducing the debt burden has dwindled in Africa in recent years as compared to when more loans were on concessional terms (Ncube and Brixiova, 2014).

Figure 6: Concessional debt (% of total external debt) for six African countries (1980 to 2017), percent



Source: Using data from the World Bank (IDS in Excel). Accessed on 8th May 2019[7].

[7] https://datacatalog.worldbank.org/dataset/international-debt-statistics

Section Four-Debt sustainability issues for Ghana

4.1 General Debt Burden in Ghana

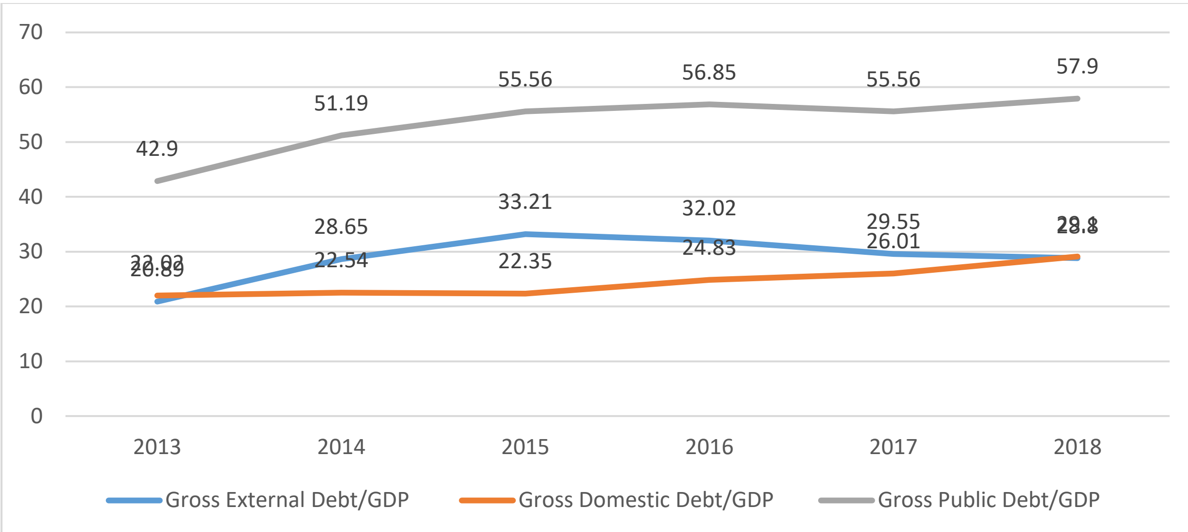
There is a saying in the Akan language in Ghana that a person who has been bitten by a snake is afraid of a worm. Ghana enjoyed debt relief under HIPC and MDRI. Ghana was the second top recipient of debt relief under HIPC and MDRI ($US 7.4 billion), the highest being the Democratic Republic of Congo with the amount of 16.3 billion US dollars (Eichengreen *et al*. 2018). Ghana is no longer a poor country, but in terms of debt, the country is getting closer to debt levels similar to when under HIPC. This should be a concern for every Ghanaian and policy makers because of the risks associated with increasing external debt.

The 2017 DSA for Ghana by the IMF (IMF, 2017) reported a debt GDP ratio of 73.9 percent for the end of 2016, which was 3.5 percentage points higher than projections by a previous DSA report. This was beyond the threshold of 70 percent set by the West African Economic and Monetary Union (WAEMU) and the Central African Economic and Monetary Community (Best *et al*. 2018). Saved by the bell! A rebasing of the GDP (from the base year of 2006 to 2013) has reduced the debt burden measured by total debt to GDP ratio. The following quotation from the recent DSA by the IMF (IMF, 2018b) shows that rebasing cannot clear the real risk: "*Based on updated macroeconomic projections, Ghana remains at high risk of external debt distress. The assessment is reinforced by the elevated total public debt-to-GDP ratio, and four of five external debt indicators in breach of the thresholds under the baseline scenario* (IMF, 2018b, page one). Thus, Ghana has been described by the last two DSAs as "high risk of external debt distress".

Changes in the composition of the total debt can be seen from Figure 7. Even after rebasing the GDP, there is a clear upward trend in the debt GDP ratio reported in the 2018 Annual Debt Report by the MOFEP. The percentage for 2018 of 57.9 percent is relatively lower as compared to the 73.9 percent reported for the end of 2016 before the rebasing. Based on the Country Policy and Institutions Assessment (CPIA) of the World Bank, Ghana is a medium performer (IMF, 2018b) and for that rank, the public debt threshold is 56 percent of GDP. This means the debt GDP ratio for 2018 is higher than what is sustainable given the constraints and structure of the economy. Projections by the IMF in the 2018 DSA, show an ever-increasing debt GDP ratio (Figure 8) assuming real GDP growth and primary fiscal balances will be at their historical averages. Throughout the period for the projections, the debt/GDP ratio would be higher than the benchmark of 56 percent by the World Bank and higher than the 70 percent specified by the WAEMU.

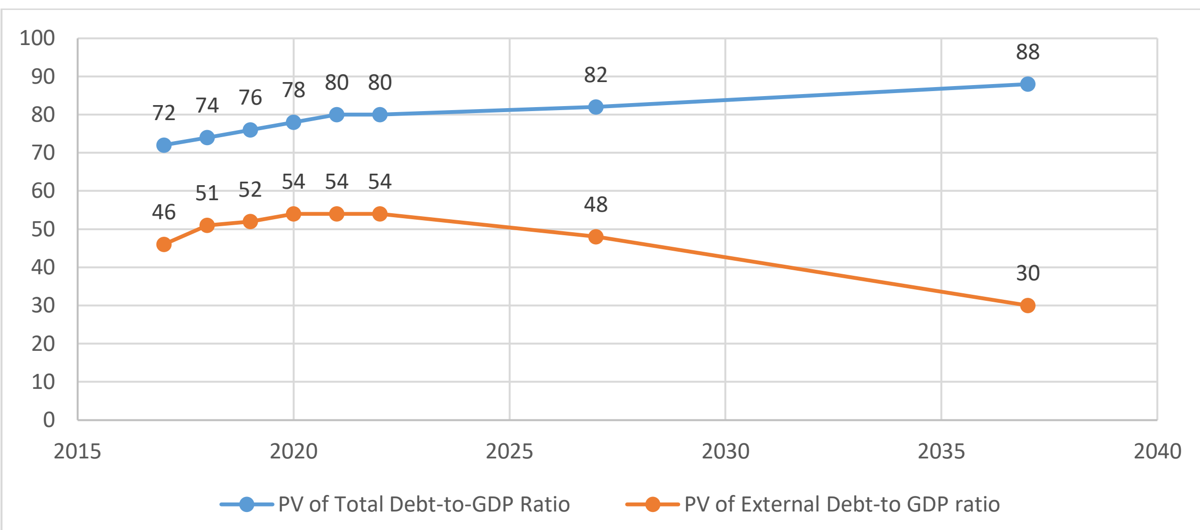
The external debt to GDP ratio has been falling consistently from the 2015 figure of 33.21 percent to 28.8 percent in 2018. Using the projections of the present value of the external debt to GDP ratio from the DSA (Figure 8), the external debt burden will rise to 54 percent by 2020 while the threshold is 40 percent. The ratio will fall below the threshold only after 2030.

Figure 7: Ghana-external debt, domestic debt and total debt, percentage of GDP: 2013 to 2018 (percent)



Source: Using figures from the 2018 Annual Debt Report for Ghana from MOFEP

Figure 8: Present value of Total Debt to GDP and External Debt to GDP-projections from IMF for 2017 to 2037 (percent)

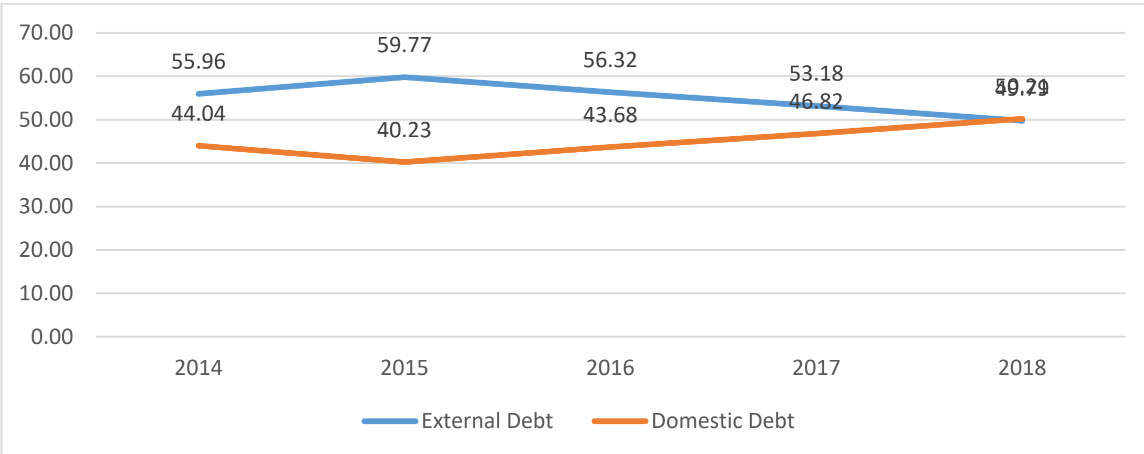


Source: Using projections from the 2018 DSA (IMF 2018b, Table 3 and Table 4)

4.2 Composition of Debt and Exchange rate risk

The share of external debt in total debt for Ghana has also been falling from about 60 percent in 2015 to just about half in 2018 (Figure 9). This should be welcome news because external debt comes with more risk as compared to domestic debt. One should not ignore "nonresidents' holdings of cedi-denominated domestic debt" which has exchange rate risk when investors decide to extract their funds from the economy to invest elsewhere (IMF, 2017). Between 2017 and 2018 the external debt increased by 13.6 percent (MOFEP, 2019).

Figure 9: The share of external and domestic debt in total debt in Ghana (percent)

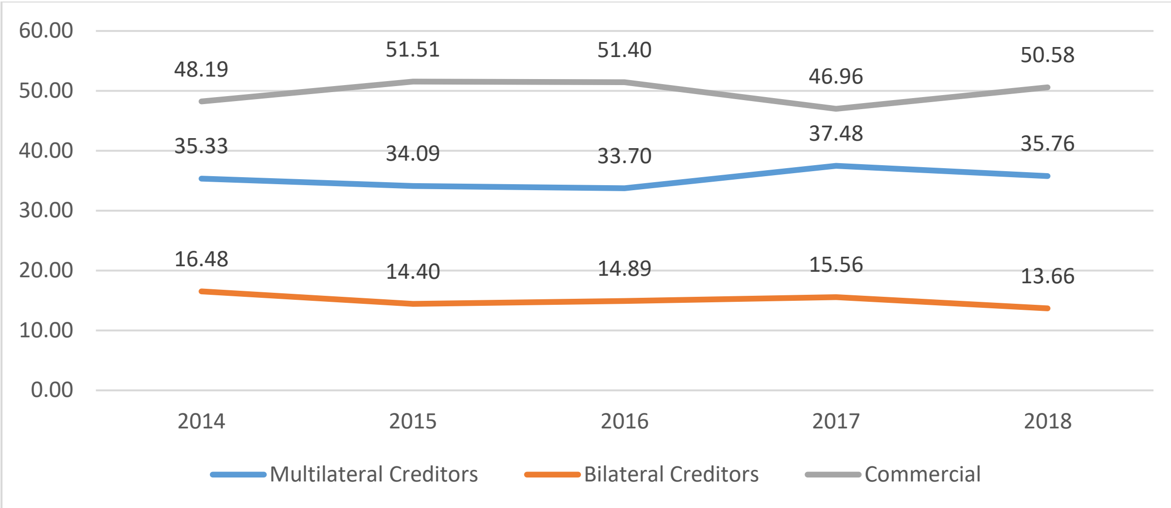


Source: Using figures from the 2018 Annual Debt Report for Ghana from MOFEP

An important aspect of external public debt for an African country is the relative share of multilateral, bilateral and commercial creditors in total external debt. This is because multilateral and bilateral loans are given under concessional terms which are very favourable to developing countries. While commercial loans are given under market terms with relatively high interest rates. Multilateral lending goes with checks, reviews and due diligence (known as conditionality) by the creditors to ensure debt sustainability. Borrowing from commercial sources do not go with such reviews. Thus for sustainability reasons, developing countries would be better off if they borrow from multilateral and bilateral sources and deal with the conditionality. The share of commercial loans is just about half (50.6%) in 2018 for Ghana (Figure 10). There is an indication that this share will increase over the coming years as development partners cut concessional funding from the year 2022 (Afrodad, 2013). The severity of the effect of borrowing from commercial sources on the payment of interest and charges can be seen in

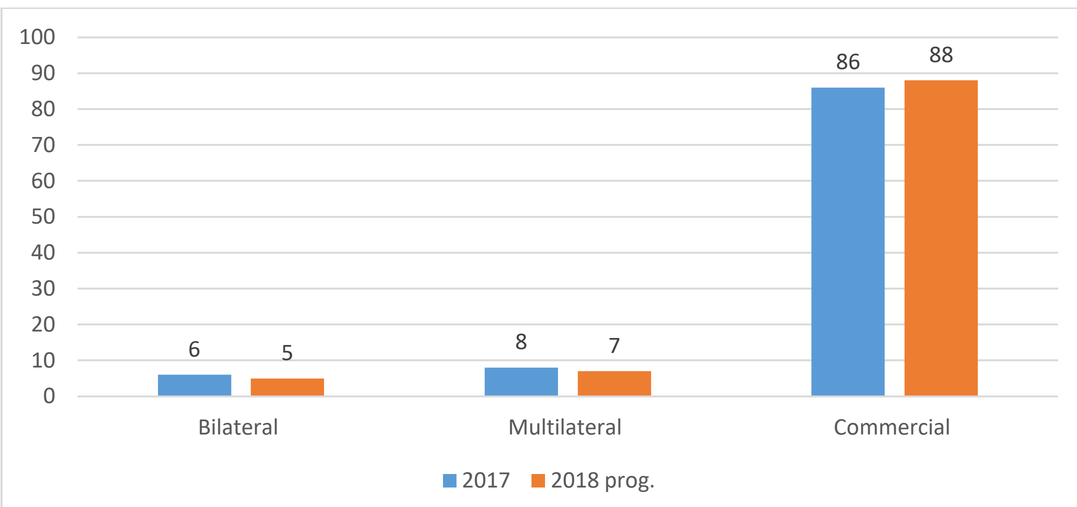
Figure 11. About 86 percent of the interest and charges payments were made to commercial sources in 2017, while only 6 percent and 8 percent were paid to bilateral and multilateral sources respectively. It was even budgeted to pay a higher percentage (88%) to commercial sources in 2018.

Figure 10: Composition Ghana's external debt- proportions for Multilateral, Bilateral and Commercial Creditors (percent)



Source: Using figures from the 2018 Annual Debt Report for Ghana from MOFEP

Figure 11: Interest and charges: proportions for each source of loan-2017 and 2018 programmed, percent



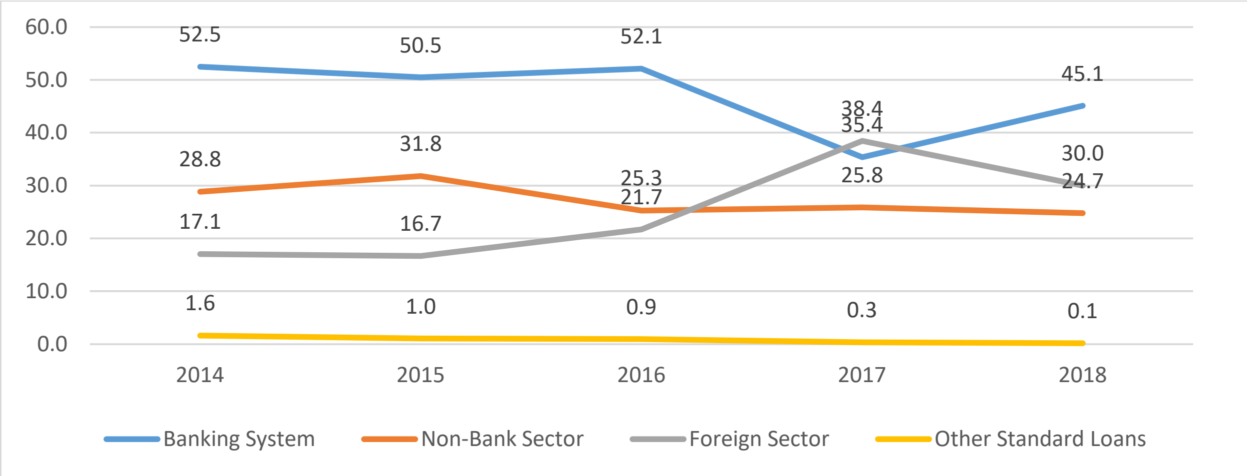
Source: Using figures from the 2018 Annual Debt Report for Ghana from MOFEP

The local banking system holds the bulk of domestic debt in Ghana (Figure 12). The share has fallen from 52.5 percent in 2014 to 35.4 percent in 2017 and further increasing to 45.1 percent in 2018 mainly because of "the issuance of GCB and CBG stocks to support the bailout of the financial sector" (MOFEP, 2019, page 39). The share held by the non-bank sector (SSNIT, Insurance Companies and Other Holders) has been relatively stable with a mild reduction (28.8% in 2014 and down to 24.7% in 2018). What is noteworthy is the rise in the share of the foreign sector, which is when non-residents buy local government medium-term instruments. The share of the foreign sector increased from 17.1 percent in 2014 to 38.4 percent in 2017 (because of investment in medium-term securities; MOFEP, 2017a) and down to 30 percent in 2018. The risk posed by the foreign sector is the depreciation of the exchange rate when investors take their funds out of the economy.

Ghana's vulnerability to the depreciation of the exchange rate has been stressed in many of the reviewed publications on debt sustainability (Battaile, Hernández and Norambuena, 2015; IMF, 2017; IMF, 2018b). In a list of countries that are expected to suffer worse debt ratios because of exchange rates depreciations, Ghana is ranked first with an expected increase of 7.9 percentage points[8]. About 67.2 percent of Ghana's external debt as at December 2018 is denominated in US dollars and 18.6 percent in Euros (MOFEP, 2019). Additionally, US$221.4 million of domestic debt are bonds sold locally in USD to mainly commercial banks. We also know that the depreciation of the cedi against the dollar was significant in 2018 and also in 2019 (MOFEP, 2019). So the exchange rates risk should be expected to get worse for Ghana.

[8] The other countries are Republic of Congo (2.6%), Mauritania (3.3%) and Sudan (6.7%), (Battaile, Hernández and Norambuena, 2015)

Figure 12: Holders of domestic debt in Ghana-2014 to 2018, percent.



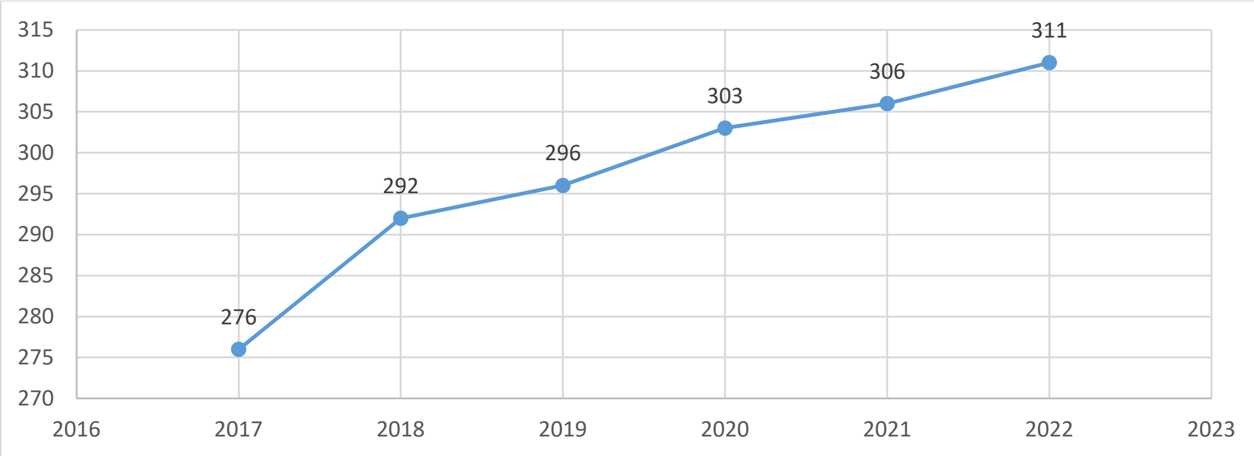
Source: Using figures from the 2018 Annual Debt Report for Ghana from MOFEP

4.3 Other measures of debt sustainability for Ghana

The present value of external debt to revenue ratio is one of the measures used in a DSA. For Ghana, Figure 13, presents the projections for 2017 to 2022 from the latest DSA by the IMF. Throughout the period of the projections, the percentages are higher than the benchmark of 250 percent for sustainability and still rising. This ratio is likely to further increase as the country continues to borrow. Low revenue mobilization is one of the main challenges for fiscal authorities in Ghana. Ghana is a lower middle income country and no longer described as poor, but in terms of revenue generation, Ghana is far below that of other lower middle income countries (UNDP, 2014). The ratio of revenue to GDP is surprisingly low. The reasons for low tax revenue are numerous. Notable is the huge number of people employed in the informal sector, who do not pay PAYE taxes. The government relies on sales taxes, which are not much difficult to collect. There is an apparent unwillingness to pay taxes because of weak institutions which are supposed to enforce compliance. The average value of the percentage of revenue to GDP for a selected number of African countries for the last decade is presented in Figure 14, using data from the IMF[9]. Only one country out of the 16 (Nigeria, 11.5%) has a lower percentage as compared to Ghana (13.3%).

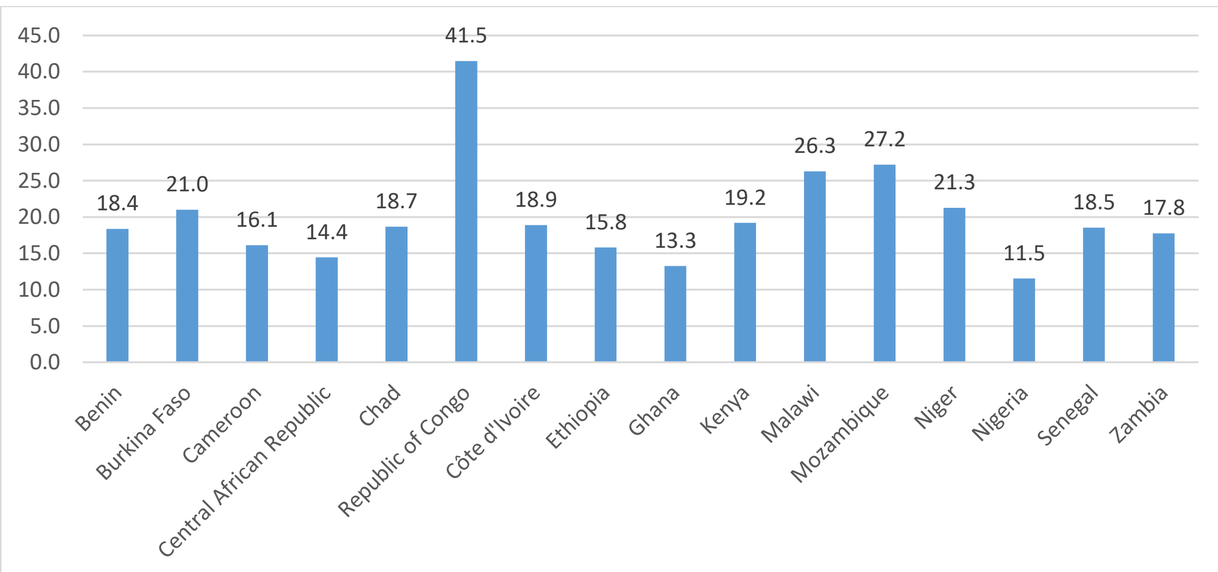
Figure 13: Projections of PV of external debt-to-revenue ratio by the IMF for 2017 to 2022, percent

[9] Revenue consists of taxes, social contributions, grants receivable, and other revenue



Source: Using projections from the 2018 DSA (IMF 2018b, Table 3, historical averages)

Figure 14: Average General Government revenue as a percentage of GDP for the period 2008 to 2017 for selected African countries.

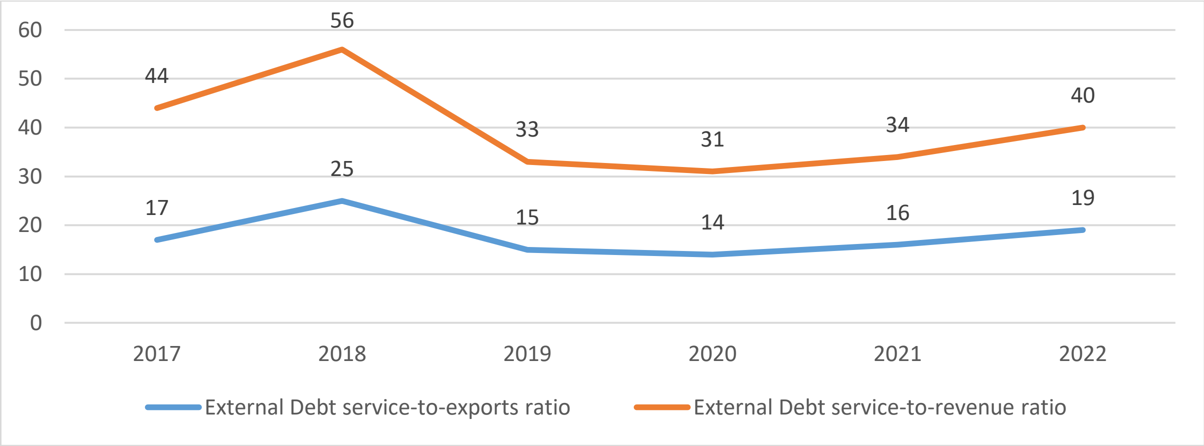


Source: Using data from the International Monetary Fund, World Economic Outlook Database. April 2019. Accessed on 8th May 2019.

The structure of these countries should not be hugely different from that of Ghana. This shows the extent of the low level of revenue collection in Ghana. This is a problem since the capacity of a country to carry debt crucially depends on domestic revenue mobilization, which would be the main source of funds to pay back the debt.

Two measures of debt sustainability reported by the IMF after a DSA are external debt service to exports and revenue, each with a threshold of 20 percent for Ghana. From Figure 15, it is obvious that projections for external debt service to revenue for Ghana from 2017 to 2022 are far above the threshold of 20 percent, even reaching 56 percent for 2018. If domestic revenue mobilization is not improved and external debt continues to increase, then we should expect the ratio to worsen. It is expected to fall and rise again to 40 percent in 2022. After reaching 25 percent in 2018, the external debt service to exports is expected to fall below the threshold and rise again to 19 percent in 2022. This explains why the country is described as high risk of debt distress, the thresholds are breached or almost breached.

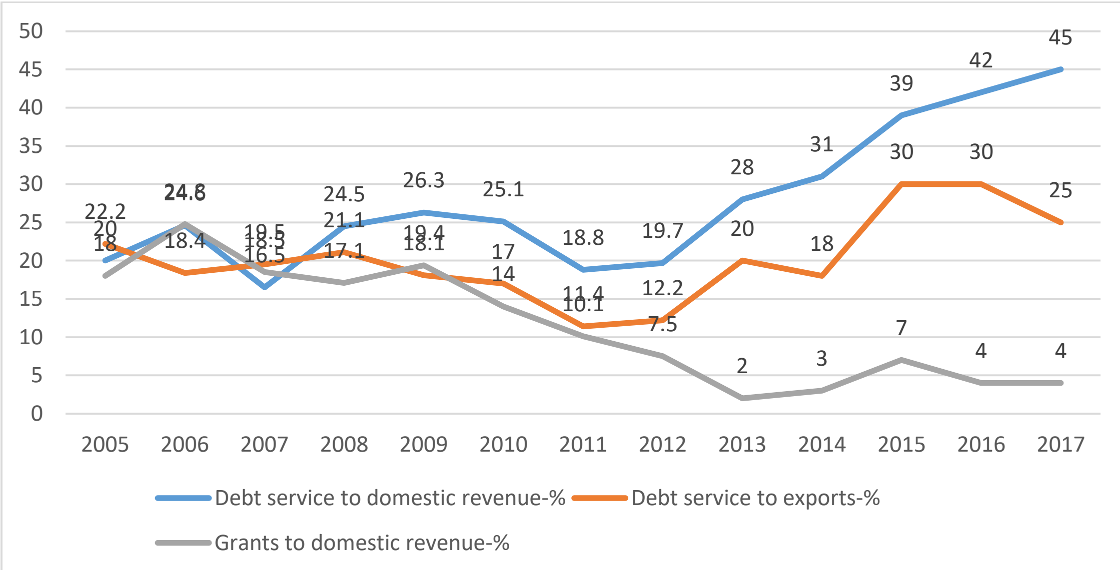
Figure 15: Projections of external debt service to exports and revenue by the IMF for 2017 to 2022 (Threshold = 20), percent



Source: Using projections from the 2018 DSA (IMF 2018b, Table 3, historical averages)

Considering total debt service to domestic revenue and exports, Figure 16, shows clear upward trends, starting from the year 2012. From around 20 percent in 2005, debt service has been above 40 percent of domestic revenue from 2016 and 2017. Grants as a percentage of domestic revenue have fallen consistently from 18 percent in 2005 to 4 percent in 2017. It should be remembered that when Ghana reached the lower middle income status, grants were signaled to fall and they continue to fall. If these trends continue, then Ghana should be heading for a full-blown debt crisis, unless drastic measures are put in place.

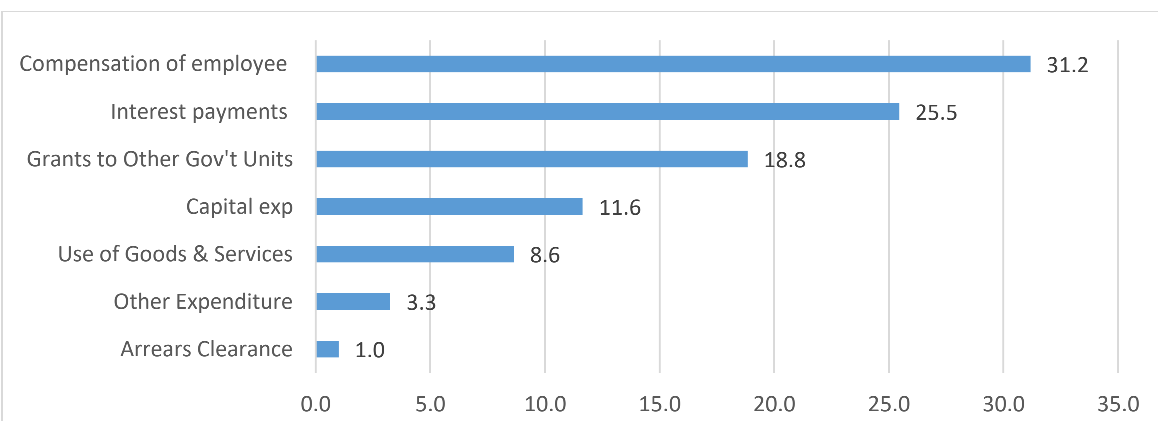
Figure 16: Debt service to domestic revenue and exports, grants domestic revenue- 2005 to 2017, percent



Source: Using data from ISSER 2018, page 68.

The high debt service ratios are reflected in the amount of interest on loans paid by the government in Ghana. The "interest burden of past debt" is one of the main drivers of debt ratios apart from primary deficits (Debrun *et al*., 2018). Interest payments constituted 45 percent of tax revenue in 2016 for Ghana (MOFEP, 2017c, p29). The proportion of expenditure budgeted to be spent on various items in the 2019 Budget Statement (MOFEP, 2018, p), is presented in Figure 17. Interest payments (25.5%), which may include amortizations, is second only to compensation of employees (31.2%). This should be worrying since only 11.6 percent would be spent on capital expenditures.

Figure 17: Budgeted expenditure for 2019 in 2019 Budget Statement, percent

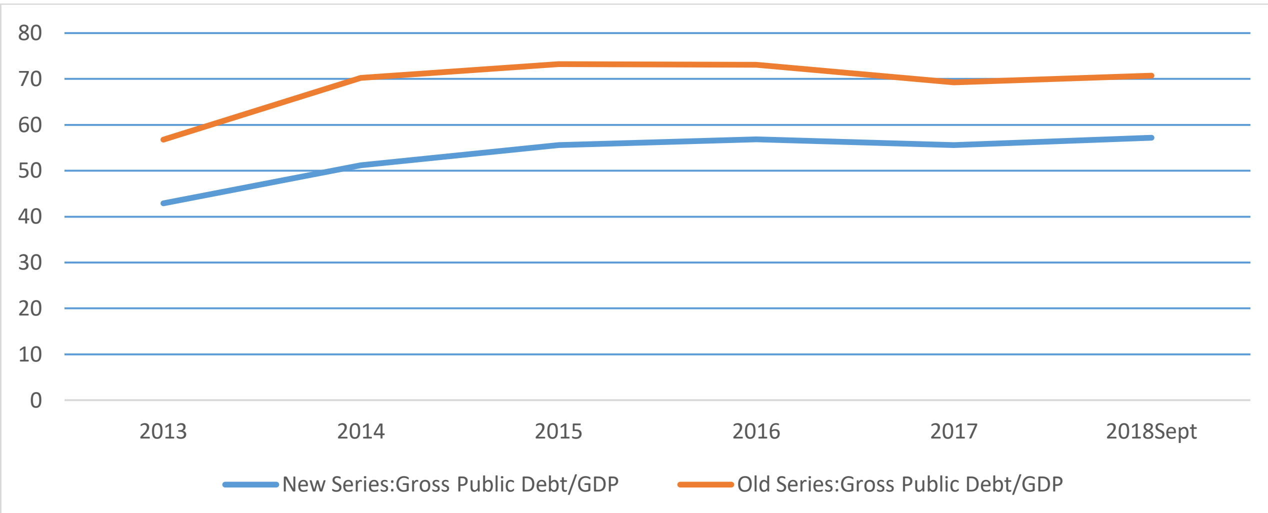


Source: Using data on Resource Allocation for 2019 in 2019 Budget Statement for Ghana (page76)

4.4 Elements of overconfidence on debt and the Eurobond issues

This subsection of the report will provide evidence of overconfidence in public debt creation in Ghana. The 2019 Budget Statement admits the effects of rebasing the GDP on the edge to over-borrow. A quote below sums it all: “the last time Ghana’s economy was rebased, in November 2010, resulting in a 63 percent upward change. It gave the then managers of the economy a false sense of security, as the debt-to-GDP ratio was significantly reduced. They went on a borrowing spree, forgetting that rebasing also exposed how very little revenue we raise through taxation” (MOFEP, 2018, par 24, page 7). The effect of the current rebasing on the debt/GDP ratio is seen in Figure 18. The debt/GDP ratio has fallen significantly. The percentage as at September 2018 is about the same as the percentage in 2013 of about 57 percent. But borrowing continues.

Figure 18: Comparing the debt/GDP ratio before and after the rebasing of GDP



Source: Data from APPENDIX 10A of the 2019 Budget Statement (MOFEP, 2018, page 237): Debt to GDP.

Publications from the MOFEP show that a lot is being done to ensure debt sustainability. Inflation has now hit single digit (9.0% in January 2019 and 9.2% in February 2019). The real GDP growth for 2017 was 8.1 as compared to 3.4 percent in 2016. Provisional projections show a growth rate of 6.3 percent for 2018. Fiscal deficit improved from 6.5 percent in 2016 to 4.8 percent in 2017 and projected to fall further to 3.9 percent at 2018 ending (using rebased figures on cash basis; MOFEP, 2019, p21). Interest rates on domestic government securities have fallen because of debt restructuring, for example, the interest rates on the 91-day treasury bills fell from 16.81 percent in December 2016 to 13.19 percent in September 2017 (MOFEP, 2017c, p31). Plans were made to cap the fiscal deficit at 5 percent of GDP (MOFEP, 2018, p67). In a letter from the MOFEP and the Bank of Ghana to the IMF, it was also reported that a Fiscal Responsibility Act has been passed to cap the fiscal deficit at 5 percent of GDP. A Fiscal Responsibility Advisory Council and a Financial Stability Advisory Council have been put in place[10]. These are good news and the efforts must be commended.

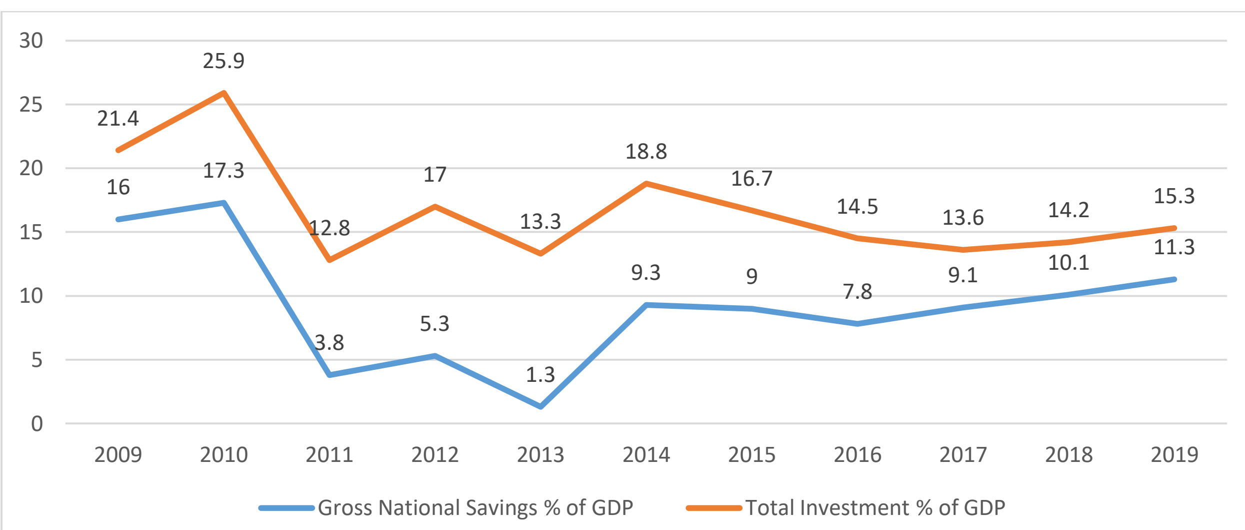
[10] Accessed on 24th April 2019.https://www.myjoyonline.com/business/2019/April-24th/the-ghana-goodbye-letter-ken-ofori-atta-and-addison-sent-to-the-imf.php

But elements of overconfidence still linger. The public debt in Ghana is exposed to exchange rates risk. The share of foreign currency debt as a percentage of total debt has fallen from 55.7 percent in 2016, 52 percent in 2017 and 48.5 percent for the end of 2018 (MOFEP, 2019, p24). But the majority of the foreign currency debt is in USD and the Euro. The share for the USD fell from about 69 percent in 2016 to about 65 in 2017, while the share for the Euro increased from about 17 percent to just above 20 percent in 2017 (MOFEP, 2017a, p17). The direction of the changes reversed in 2018 (67.1 percent for USD and 18.7 percent for Euro; MOFEP, 2019, p24). With the continued depreciation of the cedi against these two currencies and the persistent borrowing on the Eurobond market, the macro-economic gains could be wiped out or reversed if the growth of public debt is not curtailed.

The oversubscription of Ghana's Eurobond sales on the international market is another source which is deepening the extent of overconfidence by fiscal policy makers in Ghana. An example is the US$3 billion which was raised on 20th March 2019 while investors were willing to pay US$21 billion. We should mention that the interest rates are not so generous (7.875% for the 7-year, 8.125% for the 12-year bond and 8.950% for the 31-year), even though such debt is tradable as compared to loans (Arsanalp et al 2018). Also, bullet repayments, where the principal is paid on maturity, are a huge challenge and a liquidity risk (Battaile *et al*., 2015).

With the low savings culture and a high preference for current consumption as against future consumption, it is obvious that ambition is driving Ghanaian fiscal policy makers to spend more than is warranted (UNDP, 2014). A country like Japan with a very high debt/GDP ratio is supported by high private savings through institutional investors (Jonasson *et al*. 2018). The gross national savings, as a percentage of GDP for Ghana, fell from 17.3 percent in 2010 to 1.3 percent in 2013 (Figure 19). The percentage has been recovering gradually and was at 9.1 percent in 2017 and projected (by the IMF) to further increase to 11.3 percent in 2019. Total investment as a percentage of GDP is above the gross national savings to GDP throughout the period. This implies that funds from external sources are always needed to finance domestic projects. This means the country may be carrying too much debt.

Figure 19: Gross national savings and investment to GDP-2009 to 2019, percent



Source: Using Data from Regional Economic Outlook-SSA, IMF April 2018.

With the news that adjustments in growth projections for Ghana by the IMF show that the country would grow faster than any other country in sub-Saharan Africa for 2019 (at 8.8% per annum)[11], appetite for borrowing has become high. It must be remembered that cocoa prices have fallen persistently; bearing in mind that a significant part of foreign exchange earnings depends on cocoa.

There is evidence to show that when growth forecasts for a country are optimistic, the country is more likely to over borrow and worsen debt problems (Beaudry and Willems, 2018). Two examples of Greece and Mozambique are cited by Debrun *et al*. 2018. Ghana's increasing dependence on foreign investors is a problem, especially when returns are repatriated. It must be noted that the interest rates on government securities have started to rise again (91-day T-bill: 13.3% at end of 2017 to 14.6% at end of 2018; 182-day T-bill: 13.8% at end of 2017 to 15.0% at end of 2018; MOFEP, 2019, p20). This implies a greater cost of acquiring and servicing domestic debt. An important observation is that "most large emerging economies issue debt in their own currencies" (Arsanalp et al. 2018). Ghana can learn a lesson from that, to reduce foreign exchange risks. Jonasson et al. (2018), report that a number of African countries (Cote d'Ivoire, Namibia, Senegal, and Uganda) have increased their issue of local currency government bonds.

4.5 The Case of one loan contraction in Ghana: Deposit Insurance Scheme

This section of the report will discuss the contraction processes of a particular loan in Ghana. The discussion will focus on whether the process followed due diligence, with the right institutions involved. A concessional loan listed on page 238 of the 2019 Budget Statement is selected for discussion[12]. The loan was signed on 28th June 2018 for the establishment of a Deposit Protection Scheme in Ghana. Such a project is timely because of recent developments in the banking and microfinance sector in Ghana. The Monetary policy report for 2018 by the Bank of Ghana (BoG, 2018, 17) attributed a significant part of the growth of public debt in 2018 to "financial sector bailout costs". The bailout happened when a number of banks were consolidated and depositors had to be protected to maintain a stable financial sector. Thus, the burden fell on taxpayers because of the bailout. A total of ¢9,801.3 million Ghana cedis (3.2% of GDP) in bonds were issued to bail out seven banks (MOFEP, 2019, p23). Establishing a deposit insurance scheme (DIS) is meant to prevent the burden falling on taxpayers in the event of a bank failure. This will strengthen trust in the banking system and encourage savings and improve the low savings culture in Ghana as shown in Figure 19.

The importance of a DIS is discussed in Bretschneider and Benna (2017). The main benefit is a stable financial sector. Specifically, it is to avoid bank runs in the event of a bank failure. When small depositors, especially are reimbursed after a bank failure, most people would have confidence in the financial system. There are a few required initial conditions for a successful deposit insurance scheme. Macro-economic conditions must be stable to start with, and the

[11] "Ghana is number one Fastest Growing Economy in Africa in 2019" (IMF). Apr 10 2019. https://www.mofep.gov.gh/news-and-events/2019-04-10/ghana-is-number-one-fastest-growing-economy-in-africa-in-2019-imf

[12] APPENDIX 10 B: List of all Loans Signed in 2018.

banking system must be prudentially regulated. The legal framework for an independent DIS should be developed enough to allow legal action against entities that cause a bank failure. Deposit taking institutions that are insured must pay fees or premiums to benefit from a DIS.

For a DIS, “the most important aspect is always funding” (Bretschneider and Benna, 2017). The scheme can be housed within a central bank (Demirgüç-Kunt et al. 2014). The main function of a DIS is called a “pay box”, where payments are made to depositors after a bank failure. A list of regions of the world with DIS in 2013 shows that Africa is the only region where the number of countries with explicit deposit insurance is less than countries without one (Demirgüç-Kunt et al., 2014). Two countries with debt problems that have a DIS are the Central African Republic and Chad. Other African countries with a DIS are Cameroon, Congo Rep, Gabon, Kenya, Nigeria, Tanzania, Uganda and Zimbabwe. The concessional loan for the Ministry of Finance, to be borrowed from the Government of Germany, will provide part of the funds needed to establish a DIS for Ghana. The BoG is expected to pay part of the initial funding to establish the DIS.

The loan amount is 13 million euros, plus a grant element of one million euros. The interest rate charged on the loan is 0.75% per annum. It has a grace period of 10 years and a tenor of 40 years. The benefits that are being expected by the project implementers are in line with what has been reviewed in the literature, which is mainly to reduce government contingency payments in the event of a bank failure.

A review of the loan contraction process shows the involvement of key institutions in Ghana. The legislative backing of the project is the Ghana Deposit protection act, 2016 (Act 931), which was passed on 14th September 2016 for the establishment of a deposit protection corporation to manage the scheme (Ghana Deposit Protection Corporation-GDPC). Banks and specialized deposit-taking institutions would be required to make payments into the fund. Details of the loan were reviewed and discussed by representatives of the BoG and MOFEP. The MOFEP presented details of the loan to Cabinet and was approved around late 2017. After the approval by Cabinet, it was presented before Parliament for approval in early 2018. Thus, we can state that the loan contraction process for this particular loan included the right institutions in Ghana.

The loan agreement includes clauses to make sure that the loan is used exclusively to finance the initial capitalization of the deposit protection fund. Of the two tranches to be disbursed, there are conditions precedent to disbursement. The lenders would make sure that due diligence is ensured. Transparency is encouraged by the publication of key details about the financing, the preparation of books, records, and reports by consulting auditing firms. The lender reserved the right to inspect such records and has specified the sharing of information with key institutions in Germany.

The establishment of the GDPC is based on international best practice, which is explained in the Basel Core Principles for Effective Deposit Insurance Systems. Training, study trips to Deutsche Bundesbank, conferences and seminars would be organized for the staff of BoG and GDPC as accompanying measures. The GDPC shall be part of the International Association of Deposit Insurers (IADA). The checks and reviews by the lender are important because Germany has one of the best DIS in Europe, where participation in DIS is voluntary for commercial banks but offer almost “unlimited coverage for most depositors” (Demirgüç-Kunt et al., 2014). To gauge the success of the scheme indicators like the share of Ghanaians with a bank account, the share obtaining micro-insurance, Ghana's status in the World Bank's doing business report, the Global Competitiveness Index and the volume of deposits protected in the first five years.

Insurance is not new in Ghana, but deposit insurance is. Some of the anticipated challenges are how to ensure the independence of GDPC from dominance from BoG. This will certainly be difficult, as in the initial stages, the GDPC would have by the BoG and would depend on the staff and IT systems of the BoG. The public, commercial banks and Special Deposit Institutions (SDI) must be informed about deposit protection. They must accept its implementation and most importantly be willing to cooperate with it. With the European banking system, when losses from bank failures are shifted from taxpayers to bank creditors (the essence of a DIS), "losses do not disappear" (Cariboni et al. 2016). This means more must be done to prevent bank failures by the proper supervision of the BoG, rather than wait for a failure, requiring reimbursement of small depositors.

The recent closure of a number of banks and savings and loans companies in Ghana is partly contributing to the late implementation of the scheme. This is because financial institutions would be required to buy deposit insurance when established. The situation would have been better if the scheme had been finalized before these problems occurred. Details of the scheme are yet be discussed widely in media, but loan contraction continues.

4.6 A description of loans contracted in 2017 and 2018 for Ghana

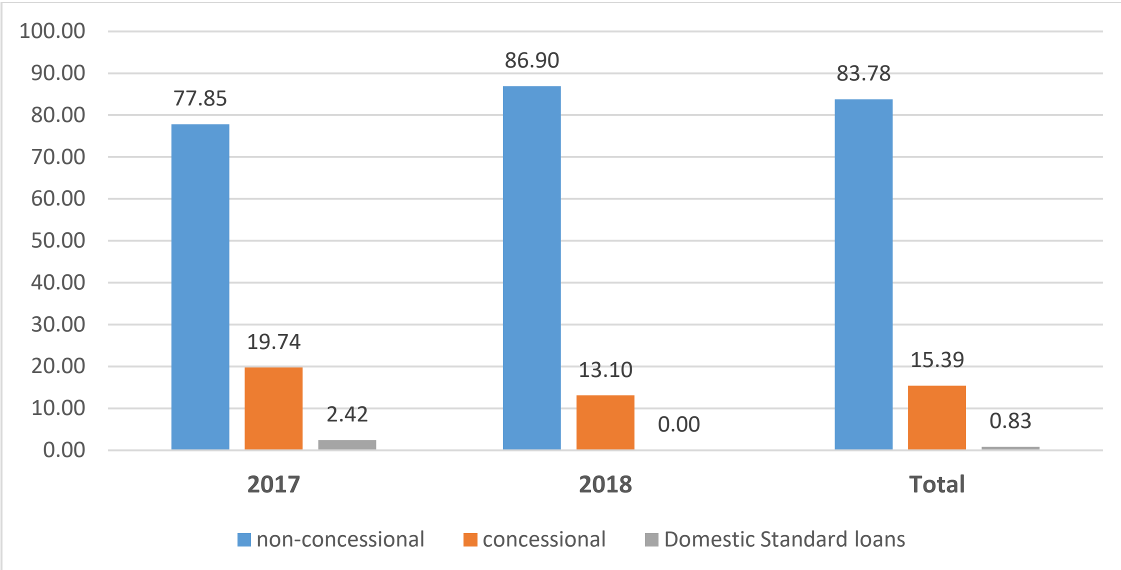
This sub-section discusses the external loan agreement signed in 2017 and 2018. In 2017, a total of ten external loans were contracted by the government as compared to a total of 24 for 2018[13]. Of the sum of US$506.8 million contracted in 2017, about 77.9 percent was under non-concessionary terms, 19.7 percent was under concessionary terms and 2.4 percent (two loans) were domestic standard loans (Figure 20). The percentage for non-concessionary increased in 2018 to about 87 percent of the total amount of US$971.6 million contracted. About 13 percent were under concessionary terms and no domestic standard loan was contracted in 2018.

The importance of keeping an eye on the proportions of loans for concessionary and non-concessionary is precisely because of the terms under which they are contracted. From Source: Using Data from The 2018 Annual Public Debt Report (MOFEP, 2019).

Figure 21, the average tenor and grace period of concessionary and non-concessionary loans, measured in years, are compared. The average tenor of concessionary loans is about 25 years as compared to about 19 years for non-concessionary loans. The average grace period for concessionary loans is about 5.7 years as compared to about 3.6 years for non-concessionary loans. This means that creditors for concessionary loans give a longer period before payments are started and more years to finish paying the loan. Comparing the interest rates and other charges concessionary loans are preferred. The average interest rate and the average of the sum of all other charges in percentages are presented in Figure 22. The interest rates and rates for other charges are lower for concessionary than for non-concessionary loans.

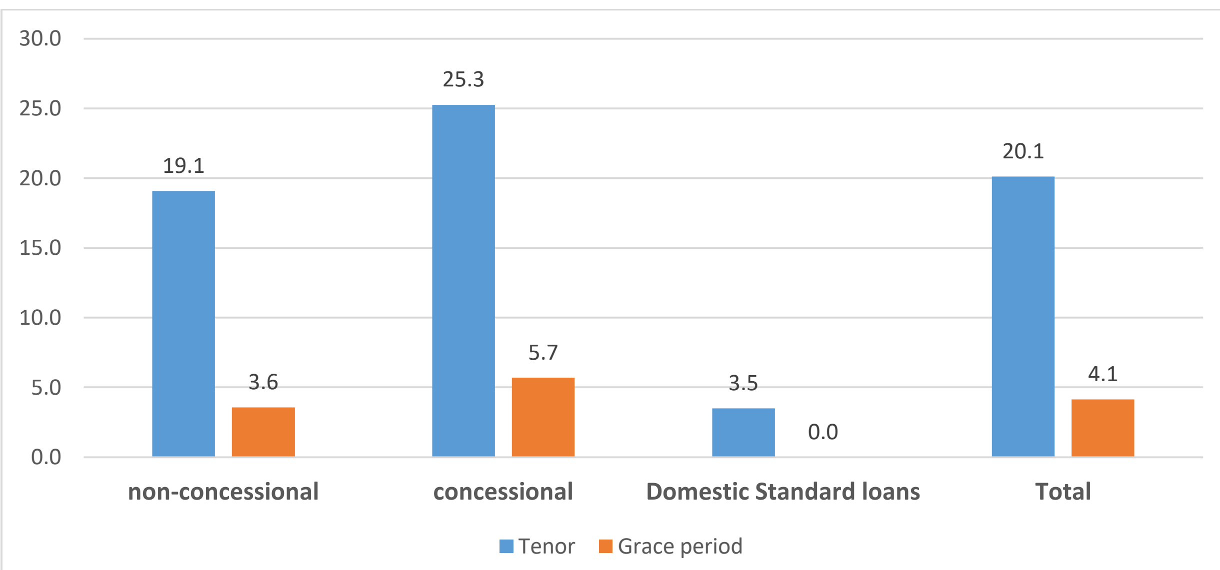
[13] The 2018 Annual debt report listed 23 loans for 2018 instead of the 24 reported here. The reason is that for the purposes of this analysis, one non-concessionary loan was split into two because the two amounts had slightly different terms- interest rates, tenor and grace periods.

Figure 20: The distribution of concessionary and non-concessionary loans for 2017 and 2018 (percent)



Source: Using Data from The 2018 Annual Public Debt Report (MOFEP, 2019).

Figure 21: The average tenor and grace period of the 2017 and 2018 loans, by type of loan (years)

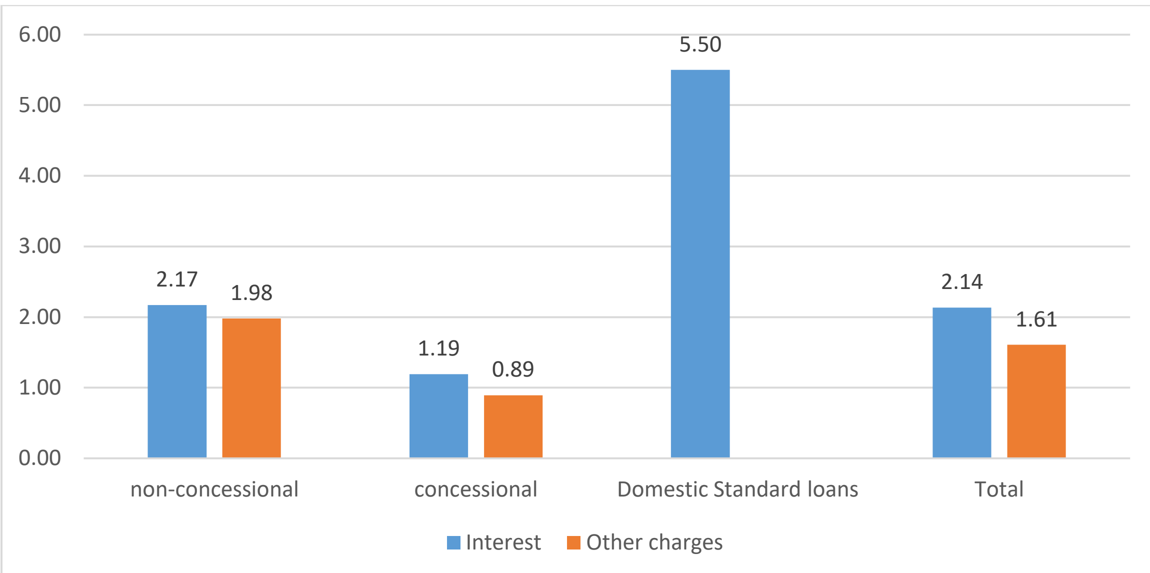


Source: Using Data from The 2018 Annual Public Debt Report (MOFEP, 2019).

The creditors of the loans contracted in 2017 and 2018 are presented in Table 1 in the appendix, along with the total amount borrowed from each creditor and the number of loans, by the type of loan. The proportions of the total amount of loans for each creditor are presented in Figure 23.

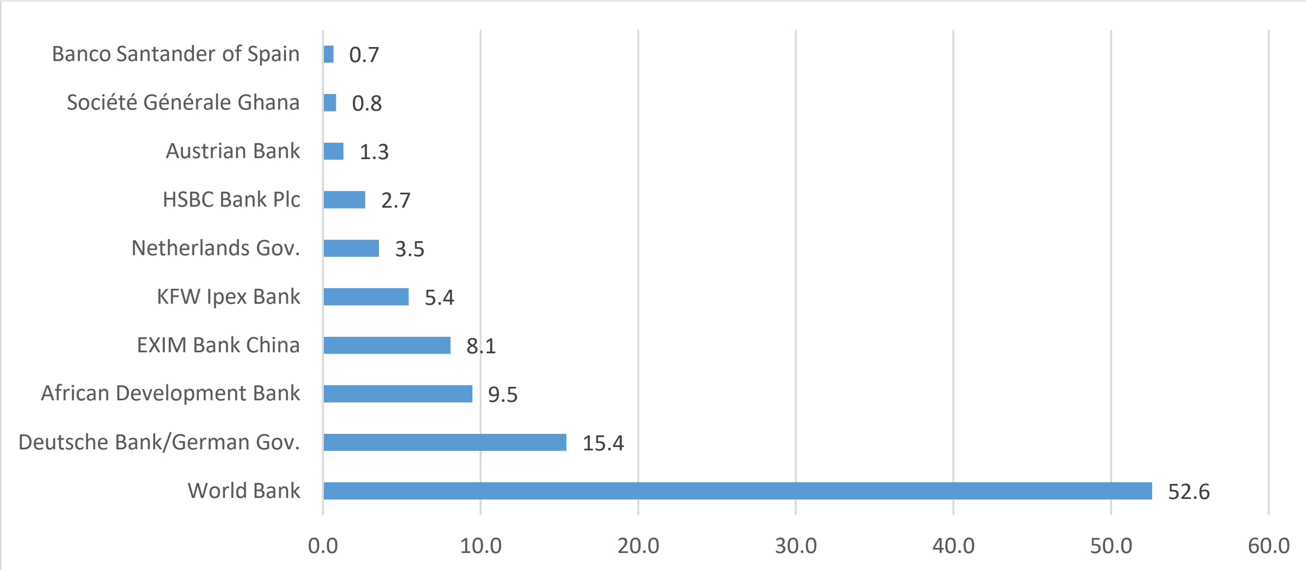
More than half of the loans (52.6%) were sourced from the World Bank. The German Government and German Banks are the sources of 15.4 percent of the loans. This is followed by the African Development Bank with 9.5 percent of the loans, Exim Bank in China with 8.1 percent and KFW Ipex Bank with 5.4 percent. The two domestic standard loans came from Société Générale Ghana Limited. For concessionary loans, three were received from the African Development Bank (representing 61.5%), the Netherlands Government gave about 23 percent and 8.4 percent came from an Austrian Bank. For the non-concessionary loans, about 62.8 percent was sourced from the World Bank, 17.1 percent had German sources and about 9.7 percent came from EXIM Bank China.

Figure 22: The average interest rates and other charges of the 2017 and 2018 loans, by type of loan (percent)



Source: Using Data from The 2018 Annual Public Debt Report (MOFEP, 2019).

Figure 23: The distribution of the total amount of loans by the creditor (percent)



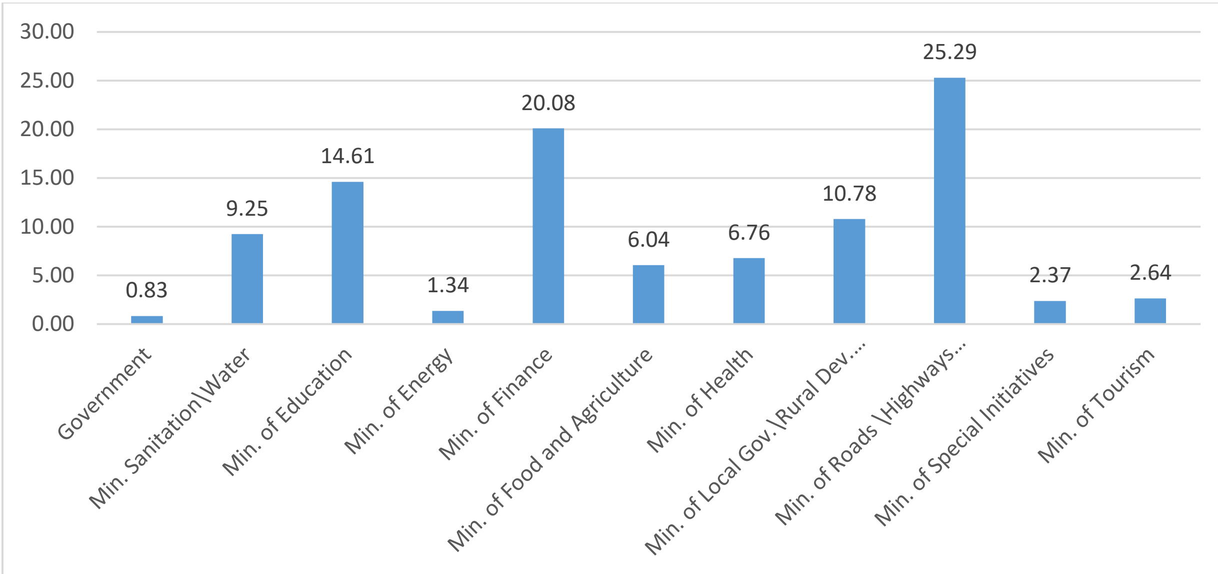
Source: Using Data from The 2018 Annual Public Debt Report (MOFEP, 2019).

The sectors or ministries of government that received the loans are presented in

Figure 24

The sectors that received higher proportions of the borrowed funds are clearly noticed. The highest proportion (25.3%) went to the Ministry of Roads and Highways and the Ministry of Transport. This is understandable because of the infrastructural deficits we have in Ghana. A little more than 20 percent of the loans went to the Ministry of Finance for Macroeconomic stability, public finance management, financial sector development projects and to establish a Deposit Protection Scheme. Other high receivers were the Ministry of Education (14.6%), Ministry of Local Government and Rural Development together with the Ministry of Gender and Social Protection (10.8%) and the Ministry of Sanitation and water resources (9.3%). Two important sectors, the Ministry of Food and Agriculture and the Ministry of Health received about 6 percent and 6.8 percent respectively. The sectoral distribution of the loans is expected to reflect the agenda of the government in terms of priorities.

Figure 24: The sectoral distribution of the loan amounts (2017 and 2018) by sector/Ministry (percent)



Source: Using Data from The 2018 Annual Public Debt Report (MOFEP, 2019).

Section Five: Conclusions and Recommendations

5.1 Conclusions

The principal objective of this report is a description of measures on the nature of the debt problem in six African countries with debt management problems. Two of these countries are in debt distress (Chad and Mozambique from 2017) and four are currently at high risk of debt distress (C.A.R., Ghana, Senegal and are Zambia). Further analysis is done in the case of Ghana. Discussions on debt sustainability have become very important because 40 percent of sub-Saharan African countries are described as currently in debt distress or have a high risk of debt distress. The analysis in this report focuses on the trends of debt sustainability measures, which can provide clear warning signals to prevent a crisis.

These countries have performed better after HIPC than before, partly due to proper debt management and debt relief. Even though four of the countries are enjoying stable growth of almost six percent on average in the last decade, the gains are at risk again because of increased borrowing after the debt relief. Challenges facing these countries are falling commodity prices, deteriorating terms of trade, falling share of multilateral debt in total debt as a result of borrowing from external private capital sources, rising interest rates and insufficient primary fiscal balances.

The main debt sustainability measure is debt/GDP. This ratio has been rising for these countries which had enjoyed debt relief under HIPC. Other measures of debt sustainability like external debt service/exports ratio, interest payments on external debt have also begun to rise. Another observation is that the share of concessional loans has fallen in recent years to an average of 47 percent in 2017, meaning the countries are increasingly borrowing from high-interest sources.

This calls for more attention and advocacy on debt management in Africa to prevent more countries from slipping into debt distress.

As the second top recipient of debt relief under HIPC and MDRI, Ghana is again getting closer to unsustainable debt levels similar to just before HIPC. The IMF reported a debt GDP ratio of 73.9 percent for the end of 2016 for Ghana, which was higher than the threshold of 70 percent set by the WAEMU. A rebasing of the GDP has reduced the debt burden measured by total debt to GDP ratio, but the external debt level of the country is still described by the last two DSAs as high risk of distress.

One positive outcome is that the share of external debt in total debt for Ghana has been falling from about 60 percent in 2015 to about 50 percent in 2018. A tricky part of this is that nonresidents hold part of the cedi-denominated domestic debt. This presents potential exchange rate risks when investors decide to extract their funds from the economy. The share of commercial loans is just about 50 percent in 2018 for Ghana. About 86 percent of the payments of interest and charges were made to commercial sources in 2017, while only 6 percent and 8 percent were paid to bilateral and multilateral sources respectively. Even though the local banking system holds the bulk of domestic debt in Ghana (45.1% in 2018), a rise in the share of non-residents in buying local government medium-term instruments has been observed, rising from 17.1 percent in 2014 to 30 percent in 2018.

It is hoped that the recent economic gains of lower fiscal deficit, lower interest rates on domestic government securities, lower or single-digit inflation rate and increasing growth rate would be sustained. Policies to improve public finance management have been made and being implemented; for example capping the fiscal deficit at 5 percent of GDP, forming a Fiscal Responsibility Advisory Council and a Financial Stability Advisory Council. The external loan agreements signed in 2017 (US$506.8 million), consisted of non-concessionary (77.9%), concessionary (19.7%) and domestic standard loans (2.4%). A total amount of US$971.6 million was contracted in 2018 (87% for non-concessionary and 13% for concessionary). The average tenor of concessionary loans is about 25 years as compared to about 19 years for non-concessionary loans in the two years. The interest rates and rates for other charges are higher for concessionary than for non-concessionary loans. More than half of all the loans (52.6%) had the World Bank as the source.

The crucial take-home message is that public debt in Ghana is exposed to exchange rate risks even though the share of foreign currency debt as a percentage of total debt has fallen from 55.7 percent in 2016 to 48.5 percent at the end of 2018. There seems to be more optimism on the part of public finance managers in Ghana and are likely to continue the borrowing spree. This calls for private efforts to induce public officers in Ghana to employ due diligence in borrowing.

5.2 Policy recommendations

5.2.1 Recommendations to Public Executives

Almost all governments have found a way to live with some form of public debt. The main issue is the size of the public debt in relation to the size of the economy and the ability of public officials to collect taxes or other revenues in the economy. Given the current tax revenue as a proportion of GDP, it would be economically prudent to scale back public expenditures and create the conditions for the private sector to fill the void so as to avoid a reduction in the growth of the economy. It is unsustainable for the government to operate beyond available resources for a long period. Efforts to manage the expectations of the public in terms of what they expect the government to do for them should precede such a scaling back. The government should begin to take a look at areas of economic activities that could clearly be operated by the private sector efficiently and create the conducive atmosphere for the private sector to thrive. Such a fiscal consolidation would certainly improve the primary balance and gradually reduce the debt stock.

One way of improving the business prospects for the private sector is to facilitate the upgrading or development of critical skills for workers in the private sector, both formal and informal. Helping existing organisations or enterprises to upgrade their skills would improve productivity and economic growth, offsetting any adverse effects of scaling down the size of the public sector.

Given the quality of the organizational skills and capabilities of public officials, and the perception of corruption in public financing, we should speed up the establishment of institutions like the public debt advisory council and discourage borrowing huge amounts in a short period of time. This would make sure that the available funds are utilized well. The monitoring capacity of public officials should be improved to keep an eye on public investments and improve debt management. It is the responsibility of public officials to ensure that public loans are used to finance projects that would bring in returns that would help to service the resulting debt.

Based on the better payment terms under which concessional loans are contracted, African public officials should not give up on their engagement with development partners so as to maximize concessional loans as much as possible. This would be easier if the funds are contracted for priority areas that are acceptable to the donors, since domestic problems of traditional donors are expected to dampen their release of concessionary loans. For sectors that are important to the government and unattractive to donors, commercial loans could then be used. But strict annual limits should be imposed on such non-concessional loans and enforced. Borrowing by district, municipal and metropolitan assemblies should be strongly discouraged or capped at reasonable levels based on the size of the internally generated funds from such assemblies.

With the Ghanaian government's goal of achieving a "Ghana beyond aid", a strong domestic revenue mobilization drive should be a key part of the discussion. Even at the prevailing tax rates, removing bottlenecks that taxpayers face would increase tax revenues. The tax base could also be broadened to include some enterprises in the informal sector that do not pay their taxes. Improving public infrastructures like roads would also improve the collection of property taxes from owners of buildings. This is important because investing in building structures is one of the main options in which Ghanaians keep their wealth. Public officials could improve tax administration by reducing manual processes and reduce the human face in tax collections. An example is the paperless port clearing system that is being implemented in Ghana.

To reduce the foreign exchange risks in debt accumulation, public officials must keep an eye on developments in the foreign exchange market to reduce depreciation of the local currency, especially those that originate from mere speculations by investors. Monetary authorities should improve their regulations in the forex market. Since it is difficult to hedge against currency risks in loan contractions in Africa, it is prudent to keep unavoidable depreciations at a low rate. Another option is to vigorously promote exports to ensure a steady supply of foreign exchange and soften the pressure on the local currency to depreciate.

It is critical to mention what would not be prudent for public officials to do so as to manage the public debt. The option of generating inflation (surprised or not) should never be considered as it would send the wrong signals and reduce efficiency in the economy. Generating inflation would increase interest rates and accelerate crowding out the private sector in the credit market. All efforts should be made to keep inflation and Treasury bill rates as low as possible. Defaults on public debt should be avoided as much as possible so as not to send the wrong signals. Defaults worsen credibility and sovereign credit ratings.

5.2.2 Recommendations to Parliament

Parliament, in addition to the Cabinet, is required to approve all public loans. When details of loans are presented to parliament for approval, the needed scrutiny and due diligence should be taken seriously on non-partisan terms as much as possible. Parliamentarians from the ruling party, by virtue of their majority, have a major responsibility to do informal discussions or consultations to ensure that loans are contracted for the right reasons and in the right manner. The desire to prevent unsustainable debt levels should guide the adherence of legal rules and procedures.

For transparency reasons, parliament should demand the publication of the status of contracted loans for government projects. Regular progress reports on the implementation of projects funded by specific loans could be provided. For loans that are not aligned to specific projects, details could be provided as to the proportions that financed traceable projects or programmes of specific ministries. Details of whether the expected benefits were derived from the funded projects could be supplied, so as to guide future attempts to contract similar loans.

5.2.3 Recommendations to Civil Society Organisations

Apart from the executive and parliamentarians, civil society organisations have a role to play to ensure public debt sustainability. Although the effects of CSOs would be felt indirectly, nevertheless it is important for them to play their part. The advocacy of CSOs could shed light on many aspects of the public debt management that would otherwise not be discussed by the executive and legislature. The dangers of pursuing commercial loans under relatively adverse terms by the executive should be spelt out clearly by CSOs. Making the public or electorate aware of such dangers would increase the heat on the executive and serve as an incentive for prudent behaviour on their part.

Even though lobbying, is mostly interpreted negatively, if done in the right way and for the right reasons, CSOs could engage the executives formally and informally about the dangers of over-borrowing. The challenge is that lobbying could involve costs that may be difficult for CSOs to bear. Getting access to influential executives like the finance minister and the economic advisory team may not be easy but worth a try.

One key role of CSOs in the current debt management issue is to shed light on the advantages of contracting loans from international financial institutions that require some form of conditionality before disbursement. The advantage is that taking loans from such institutions is an indication that the government is committed to prudent financial behaviour. This is because such creditors have the reputation of making sure that governments follow due process in the use of the funds as compared to borrowing from the open market.

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APPENDIX TABLES

Table 1: The sum of loans (number) by creditor and type of loan-2017 and 2018, Million USD

Creditor	non-concessional	concessional	Domestic Standard Loan	All Loans	Grant Element of Loan
African Development Bank	-	139.34 (3)	-	139.34 (3)	
Austrian Bank	-	19.07 (2)	-	19.07 (2)	
Banco Santander of Spain	9.70 (1)	-	-	9.70 (1)	
Deutsche Bank/German Gov.	211.23 (7)	15.99 (1)	-	227.22 (8)	1.23 (1)
EXIM Bank China	119.10 (1)	-	-	119.10 (1)	
HSBC Bank Plc	39.20 (2)	-	-	39.20 (2)	
KFW Ipex Bank	80.00 (2)	-	-	80.00 (2)	
Netherlands Gov.	-	52.19 (2)	-	52.19 (2)	26.50 (2)
Société Générale Ghana	-	-	12.25 (2)	12.25 (2)	
World Bank	774.42 (11)	-	-	774.42 (11)	
Total	1,239.66	226.58	12.25	1,472.49	27.73

Note: The number of loans per cell in parenthesis.

Table 2 : The average interest rates (rates for other charges) for all loans by creditor and type of loan

Creditor	non-concessional	concessional	Domestic Standard Loan	All Loans
African Development Bank		1(1.25)		1(1.25)
Austrian Bank		0.95(0.75)		0.95(0.75)
Banco Santander of Spain	1.3(2.2)			1.3(2.2)
Deutsche Bank/German Gov.	3.04(2.75)	0.75(0.25)		2.76(2.44)
EXIM Bank China	2(0.5)			2(0.5)
HSBC Bank Plc	3.48(3.75)			3.48(3.75)
KFW Ipex Bank	3.38(2.52)			3.38(2.53)
Netherlands Gov.		1.95(0.83)		1.95(0.83)
Société Générale Ghana			5.5	5.5(0)
World Bank	1.25(1.12)			1.25(1.19)
Total	2.17(1.98)	1.19(0.89)		2.14(1.61)

The rates for other charges (commitment fee, structuring fee, risk mitigation, arrangement fee, service fee or management fees) in parenthesis

Table 3: Average tenor (grace period) of the loans, in years

Creditor	non-concessional	concessional	Domestic Standard Loan	All Loans
African Development Bank		31.7(5)		31.7(5)
Austrian Bank		21.3(7.8)		21.3(7.8)
Banco Santander of Spain	12(0)			12(0)
Deutsche Bank/German Gov.	10.6(2)	40(10)		14.3(3.1)
EXIM Bank China	20(5)			20(5)
HSBC Bank Plc	8.5(1.8)			8.5(1.8)
KFW Ipex Bank	7.5(1.5)			7.5(1.5)
Netherlands Gov.		12.25(2.5)		12.3(2.5)
Société Générale Ghana				3.5(0)
World Bank	29.1(5)			29.1(5)
Total	19.1(3.6)	25.3)5.7		20.1(4.1)

Note: The average grace period in parenthesis (years).