INSTITUTE FOR FISCAL STUDIES

Occasional Paper No.3

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Physical Address
No. 13, 2nd Close, Airport Residential Area, Accra, Ghana

Postal Address
P.O. Box CT 11260, Cantonment, Accra, Ghana

+233 302 786 991
info@ifsghana.org
www.ifsghana.org

Ghana: Public Debt and Debt Sustainability Issues

Prepared by the staff team of the IFS

1 June 2015

The views expressed in this paper are the views of the IFS

All enquiries should be directed to:

The Executive Director, IFS

P.O. Box CT 11260, Cantonment, Accra, Ghana

Abstract

Ghana's public debt situation has worsened in recent years and the country now faces a high risk of debt distress and increased overall debt vulnerability. Total public debt service-to-revenue ratio (including payments on external and domestic debt) has not only assumed a rapidly increasing path but has breached its indicative long term threshold. Debt service now absorbs a large part of domestic revenues, leaving the country vulnerable to shocks. All other debt indicators have deteriorated owing to deteriorated domestic and external borrowing conditions, weak fiscal consolidation, and weakening of the domestic currency. Maintaining the country's debt sustainability will require carefully designed fiscal consolidation measures combined with a more ambitious medium-term adjustment to spur robust economic growth, enhance domestic revenue mobilization and reduce the worsening debt and debt-service indicators.

1. Introduction

Since the Monterrey Consensus in 2002, there has been considerable change in the landscape for sovereign debts. Strengthened macroeconomic and public resource management and substantial debt reduction through the heavily indebted poor countries (HIPCs) and multilateral debt relief initiatives (MDRIs) have led to a substantial decline in the vulnerability of many countries to sovereign debt distress. Despite the improved efforts at debt sustainability and crisis prevention, sovereign debt distress continues to occur. Many countries continue to remain vulnerable to debt crises and some are in the midst of crises. Recent increases in the issuance of domestic currency debt, along with increased borrowing from emerging official creditors and the private sector have complicated the landscape for debt sustainability and crisis prevention for many developing countries, including Ghana.

The purpose of this study is to examine the issue of debt and debt sustainability in Ghana as the country's public debt stock has risen substantially since it enjoyed HIPC and MDRI debt relief in 2005-06. The paper is organized as follows. Section two examines the debt trends in developing countries, particularly in sub-Saharan Africa to provide the context for Ghana's debt and its sustainability issues. Section three reviews the recent debt developments in Ghana, focusing on the trends, management, sustainability, and risks. Section four covers the policy considerations for maintaining debt sustainability while section five concludes the study.

2. Recent Debt Trends in Developing Countries

Total external debt stock of developing countries amounted to US$2.6 trillion at end-2008 and was estimated to have reached US$ 3.8 trillion in 2009, registering an increase of over 46 percent over the period. Estimates made by the United Nations Conference on Trade and Development (UNCTAD) indicate that the debt levels continued to grow by approximately 12.0 percent over 2009-2012, bringing the total external debt of developing countries to an estimated US$5.4 trillion in 2012. This marked the third consecutive time that the growth of external debt of developing countries reached 10 percent, following nearly a decade of average growth of around 7.0 percent. Long-term debt represented 70 per cent of the total debt stocks and was mainly owed to private creditors. The share of official long-term lending to developing countries continued to decline in 2011 and 2012. At the same time, the share of short-term debt increased from US$485.3 billion in 2000-2008 to US$1.2 trillion in 2011 and to an estimated US$1.4 trillion in 2012, constituting more than a quarter of the total debt stocks. For the group as a whole, debt ratios are estimated to have worsened in 2012 after a slight improvement in 2011. From 2011 to 2012, total debt to GDP increased from 20.7 percent to 22 percent, debt service to exports rose from 7.9 percent to 8.5 percent, and total debt to exports increased from 68.3 percent to 75.2 percent. International reserves for all developing countries increased to US$6.3 trillion in 2012 from US$1.9 trillion in 2000-2008 (UNCTAD, 2013).

In sub-Saharan Africa, total external debt stock reached US$313.2 billion in 2012 as debt continued to grow by 6.4 per cent per annum between 2000-2008 and 2012, though at a slower pace than the 9 per cent growth recorded in 2011. The region's share of total debt stocks of developing countries continued to decline, reaching 5.8 percent in 2012. The majority of the region's total debt is long-term (accounting for 79.3 per cent between 2009 and 2012), of which less than half is owed to official creditors. The region's debt ratios have improved markedly since 2000 owing in large part to the debt relief delivered under the HIPC and MDRI, and continued economic growth. Total external debt-to-GDP ratio averaged 24.6 percent over 2009-2012, compared with 62.5 per cent in 2000. The total-debt-to-exports ratio was 66.1 per cent in 2012, down from 182.6 per cent in 2000, and the debt-service-to-exports ratio was also 3.5 per cent in 2012 as against 10.5 per cent in 2000. In addition, international reserves have steadily increased in sub-Saharan Africa to US$200.1 billion in 2012, reflecting more than five times the level in 2000.

For a long time, most sub-Saharan African countries have had to rely on foreign assistance or loans from international financial institutions to meet part of their foreign currency needs. But now many of them are able to borrow in international financial markets, selling Eurobonds which are usually denominated in dollars or euros. Ghana, Gabon, Côte d'Ivoire, Kenya, Namibia, Nigeria, Rwanda, Senegal, Seychelles, Tanzania, Uganda and Zambia, among others, have all been able to raise funds in international debt markets. In total, more than 20 percent of the 48 countries in sub-Saharan Africa have sold Eurobonds. Moreover, a few corporate entities in sub-Saharan Africa have also successfully issued Eurobonds. Guarantee Trust Bank in Nigeria raised $500 million in a five-year bond offering in 2011 and Ghana Telekom issued US$300 million in five year bonds in 2007 (Sy, 2013). The sudden surge in borrowing by countries in a region that contains some of the world's poorest nations has been facilitated by changes in the institutional environment, strong economic growth and better economic policies in some of the countries in the region, low interest rates (low borrowing costs) in advanced economies, continued economic stress in many major advanced economies, especially in Europe, high global liquidity combined with investors seeking risk-adjusted returns and diversification opportunities, and reduced debt burdens. In several cases, some African countries have been able to sell bonds at lower interest rates than troubled European economies such as those of Greece and Portugal.

Many countries in the region are experiencing debt sustainability problems. Sudan was in debt distress while Burundi, Comoros, Democratic Republic of the Congo, Djibouti, Guinea, and Gambia were at high risk of debt distress. Both the Comoros and Guinea reached the completion point in 2012 under the HIPC Initiative and, as a result of the debt cancellation obtained from the Paris Club, they were not considered to be in debt distress. The increase in debt-to-GDP ratio following the MDRI has been quite significant in several countries, including Benin, Ghana, Senegal and Malawi, where the surge in the debt ratio largely reflects sharp exchange rate depreciation, rather than new borrowing (except in Ghana's case). Overall the growth performance of many sub-Saharan African countries has improved in recent years. While some of these countries experienced an acceleration of growth due mostly to a significant recovery in the oil sector (Angola), or new extractive operations (Ghana, Sierra Leone), growth contracted in many others, including Guinea-Bissau, Mali, and Uganda, owing to various reasons, including internal conflicts and tightening of monetary policy. Furthermore, fiscal space has deteriorated for a number of sub-Saharan African countries as a result of sluggish growth and higher fiscal deficits.

Within the sub-Saharan African group, the performance of the external sector has varied markedly as oil exporters typically recorded improved trade and current account positions, whereas non-oil mineral exporters have seen their balances deteriorate. In 2012, the current account of a number of countries in the region worsened, reflecting in part the continued sluggish performance of exports in several cases and the strong rising import demand observed in countries, such as Burkina Faso, Guinea and Mozambique.

The majority of sub-Saharan African countries have huge infrastructure needs, such as electricity generation and distribution, roads, airports and ports, and therefore require a large demand for new resources to be invested. The way investment projects are financed will thus have a significant impact on both the long-term growth and the sustainability of the debts of many sub-Saharan African countries. Some of these countries have fewer opportunities and sources of financing compared with other developing countries. With a few exceptions, domestic debt markets are not sufficiently developed, especially in the long-maturity segment, and the resources that can be raised are constrained by the limited amount of savings. Developing a domestic debt market is also costly in terms of financial and human resources. More importantly, domestic borrowing cannot fully replace external financing because many of the African countries have to raise foreign exchange to buy foreign capital goods and equipment for investment projects. The current account imbalances of many of these African countries suggest that foreign capital will continue to play an important role in their development.

Foreign capital flows to sub-Saharan African countries have mainly been in the form of concessional loans from official donors or foreign direct investment (FDI), with FDI rising in recent years. The high share of FDI in total capital flows to the region is partly due to the very small amount of private loans and portfolio investments. In the case of those countries where debt is deemed sustainable, little borrowing on commercial terms reflects the stringent limits that they have to abide by for non-concessional borrowing in order to continue to obtain access to highly concessional loans from the IMF and the World Bank. However, since 2009, the IMF limits on borrowing at non-concessional terms for countries under IMF-supported programs have become more flexible, and exemptions have been granted on the basis of an assessment of countries' capacities and the extent of their debt vulnerabilities. For example, Ghana, Senegal and, more recently, Rwanda and Tanzania received exemptions from the concessionality requirements by the IMF and were therefore able to place bonds on international markets (UN, 2013).

3. Ghana: Debt Profile

3.1. Recent Trends

Ghana's external debt and total public debt stock rose substantially after its MDRI debt relief in 2005-06, indicating a rise in risks to debt sustainability. The highly expansionary fiscal position in 2006-08, financed by external borrowing triggered a very rapid deterioration in the country's debt sustainability. This trend was amplified by the resulting balance of payments pressures and currency depreciation, which led to a revaluation of foreign currency-denominated claims relative to domestic GDP. The debt surge was effectively stemmed when the country's access to market financing was closed off due to the global financial crisis in 2007-08.

Ghana's public debt stood at US$8.1 billion at end-2008, which was equivalent to 34.8 percent of GDP. This reflected the larger than previously assumed fiscal deficit in 2008 (14.5 percent of GDP, or 4 percentage points higher than previously projected) as well as the impact of the currency depreciation on the foreign debt-to-GDP ratio. Public sector external and domestic debts were almost equal in size at end-2008, each close to US$4 billion (17.4 percent of GDP each). External debt rose rapidly from 10.7 percent in 2006 to 17.4 percent of GDP in 2008(Table 1), reflecting the US$750 million Eurobond issued at end-2007, together with new concessional bilateral financing and loans contracted from the IDA over the period following the Multilateral Debt Relief Initiative (MDRI).

External debt totaled US$6.2 billion at end-2010, up from US$4.0 billion in 2008, reflecting largely borrowing from bilateral and multilateral institutions, including the IMF under the ECF program. Non-concessional and other commercial borrowings were at a more modest pace.

Table 1. Ghana: Total Public Debt, 2006-15

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015*
In millions of US$										
External Debt	2,177	3,590	4,035	5,008	6,254	7,653	9,154	11,462	12,968	13,773
Domestic Debt	3,133	3,819	4,038	4,296	5,683	7,697	10,026	12,121	10,819	9,752
Total Public Debt	5,310	7,409	8,073	9,304	11,937	15,350	19,180	23,583	23,787	23,525
In millions of Cedis										
External Debt	2,010	3,484	4,886	7,161	9,193	11,866	16,649	25,216	41,498	51,610
Domestic Debt	2,894	3,705	4,902	6,143	8,280	11,841	18,431	26,666	34,621	36,543
Total Public Debt	4,904	7,189	9,788	13,304	17,473	23,707	35,080	51,882	76,119	88,153
As % of Total Public Debt										
External Debt	41.0	48.5	49.9	53.8	52.6	50.1	47.5	48.6	54.5	58.5
Domestic Debt	59.0	51.5	50.1	46.2	47.4	49.9	52.5	51.4	45.5	41.5
As % of GDP										
Total Public Debt	26.2	31.0	34.8	36.0	38.9	41.6	48.4	55.3	67.1	65.3
External Debt	10.7	15.0	17.4	19.4	20.3	20.8	23.1	26.9	36.6	38.3
Domestic Debt	15.5	16.0	17.4	16.6	18.6	20.8	25.3	28.4	30.5	27.0

*as at end- March 2015

Source: GoG Budget Statement, various sources; Bank of Ghana, Quarterly Economic Bulletin, various issues

Total public debt of GH₵17.5 billion at end-2010 was higher than projected by the IMF in the combined first and second reviews under the Extended Credit Facility (ECF) program. The total public debt at end-2010 represented 38.9 percent of GDP, some 1.0 percentage point higher than the projected figure in the Fund's 2010 debt sustainability analysis. This reflected a larger-than-programed fiscal deficit and the associated increases in domestic financing. In addition, the government continued to accumulate domestic payment arrears in 2010. At end-2010, the outstanding stock of arrears and public liabilities in respect of SEO debts was estimated at 9 percent of GDP, which previously was not reflected in the public debt data (IMF, 2015). About one-third of these liabilities were to be cleared in 2011 through a mixture of cash payments and bond issues. The arrears element was therefore added to the debt balance at end-2011 and any residual balance was to be regularized through cash outlays or bond issues in 2012–13, adding to the debt burden over that period.

Ghana's public debt situation worsened after 2012 as the country faced a high risk of debt distress and increased overall debt vulnerability. Total public debt rose sharply from GH₵35.1 billion or 48.4 percent of GDP in 2012 to GH₵76.1 billion, equivalent to 67.1 percent of GDP in 2014 and by end-March 2015, the total public debt stock had reached GH₵88.2 billion, representing 65.3 percent of GDP. This implies that the debt stock increased by GH₵53.1 billion or over 151 percent between December 2012 and March 2015, made up of GH₵6.2 billion in 2012, GH₵16.8 billion in 2013, GH₵24.2 billion in 2014, and GH₵12.0 billion in the first three months of 2015. Of the end-March 2015 public debt stock, GH₵51.7 billion, equivalent to 38.3 percent of GDP, was external debt, implying that external debt increased by GH₵35.0 billion, or some 210 percent, between 2012 and March 2015 (Table 1).

Ghana has long relied on foreign assistance or loans from international financial institutions to supply part of its foreign currency needs. But non-concessional external debt stock increased significantly from US$90.1 million to US$838 million in 2008, and then to USD1.45 billion in 2012. In 2007 and the last two years also the country borrowed from the international financial markets, selling Eurobonds, which were denominated in dollars. The government also plans to issue another Eurobond in 2015 to raise US$1.0 billion, bringing to a total of US$2.75 billion Eurobonds issued in three consecutive years. This has enabled the country's external debt to once again overtake domestic debt as the major contributor to total public debt (see Table 1).

The sharp increase in non-concessional external financing reflected the fundamental changes in the country, notably the overall strong performance of the economy and, more importantly, the middle-income status achieved by the country in 2010. But while the gradual shift from concessional to non-concessional borrowing does not directly affect the size of the total public debt and thus the debt-to-GDP ratio, it has serious implications for the country's debt sustainability as most of the non-concessional loans have shorter maturities and larger debt service costs.

The sudden surge in borrowing in Ghana is due to a variety of factors, including the rapid growth and better economic policies pursued in the country (notably between 2009 and 2012), low global interest rates, and continued economic stress in many major advanced economies, especially in Europe. It appears that cheaper external debt than domestic debt has also been a major contributory factor behind the country's increased borrowing from the international capital market. For instance, in January 2013, the government would have paid about 4.3 percent on a 10-year borrowing in dollars (reflected in secondary market yields on the offering). However, had the government borrowed in local currency domestically, the interest rate would have been at least 23 percent on three-month treasury bills. After inflation differentials are taken into account, the difference between the U.S. dollar and local currency borrowing costs reached 10.6 percentage points (5.4 percentage points, taking into account currency depreciation). This difference was due in part to changes in the policy environment, i.e., monetary policy was tightened in 2012 and the fiscal deficit increased significantly. But the difference was also due to a low external cost that reflected foreign investors' search for yield, their confidence in the country's willingness to repay its debt obligations, and its ability to do so because of its positive growth prospects. Another factor was the underdeveloped domestic debt markets with an investor base dominated by commercial banks—which raises domestic borrowing costs—and probably the effects of restricting foreign investors from buying domestic government securities with a maturity of less than three years.

Long-term external debt constituted 100 percent of the total external debt stock in 2006-2012, and was owned mainly by official (multilateral and bilateral) creditors. Official creditors accounted for on average 81.1 percent of the total external debt during 2007-2012, comprising an average of 48.5

percent for multilateral creditors and 32.6 percent for bilateral creditors. Private creditors' share in the total external debt averaged 18.8 percent over 2007-2012 (Table 2).

Table 2. Ghana: External Debt Stock, 2006-2012 (US$ million, unless stated otherwise)

Item	2006	2007	2008	2009	2010	2011	2012
Maturity (original)							
Long term	2,177	3,586	4,036	5,008	6,254	7,653	9,154
Short term	-	-	-	-	-	-	-
Total	2,177	3,586	4,036	5,008	6,254	7,653	9,154
Creditor Category							
Multilateral	1,327	1,710	2,028	2,462	3,058	3,696	4,281
Bilateral	760	978	1,168	1,687	2,169	2,955	2,983
Private	90	898	840	859	1,027	1,002	1,890
Total	2,177	3,586	4,036	5,008	6,254	7,653	9,154
As Percentage of Total							
Multilateral	61.0	47.7	50.2	49.2	48.9	48.3	46.8
Bilateral	34.9	27.3	28.9	33.7	34.7	38.6	32.6
Private	4.1	25.0	20.9	17.1	16.4	13.1	20.6

Source: Ministry of Finance (2012)

Rising interest costs, reflecting increased borrowing and higher public debt has resulted in a huge and increasing interest payment burden. Total interest payment, which stood at GH₵1.0 billion or 2.7 percent of GDP in 2009, had by 2012 reached GH₵2.4 billion or 3.4 percent of GDP. The outturn of total interest payment in 2014 was GH₵7.8 billion, equivalent to 6.8 percent of GDP. The projected outturn of interest payment in 2015 is GH₵9.6 billion, equivalent to 7.1 percent of GDP. This means that between 2009 and 2012, interest payments increased by GH₵1.4 billion or 140 percent and between 2012 and 2015, it is projected to increase by GH₵7.1 billion or 300 percent. Interest payments accounted for 17.6 percent of domestic revenue in 2009 and dropped to 15.5 percent in 2012. In 2014, interest payments amounted to 32.6 percent of total domestic revenue, and at end March 2015, it accounted for 26.5 percent (Table 3). This is indeed very alarming because the interest payment burden which is expected to reach 7.1 percent of GDP in 2015 is getting closer to the level that pushed the country to opt for the HIPC debt relief in 2001. In fact, the 6.8 percent of GDP interest payments in 2014 and the projected 7.1 percent in 2015 would be two successive years since 2000 that total interest payments would have been larger than total capital expenditure.

Table 3. Ghana: Interest Payments on Public Debt

	2009	2010	2011	2012	2013	2014	2015*
In Million Cedis	1,032.3	1,439.4	1,611.2	2,436.1	4,397.0	7,080.9	9,577.2
As % of Domestic Revenue	17.5	18.2	13.7	15.5	23.5	32.6	27.4
As % of GDP	2.7	3.0	2.7	3.4	5.1	6.8	7.1

*projected

Source: Government of Ghana, Budget Statements (various sources)

3.2 Debt Management Strategy

To support the government's goals for debt and fiscal sustainability, a comprehensive public debt management strategy was adopted by the government in 2009 to provide a clear framework for borrowing, establishing the principles that should guide the debt manager's decision regarding the currency composition, maturity, interest rates and other risks of the debt portfolio. Under this strategy, the government will have to explore all sources of concessional financing, while seeking to avoid non-concessional borrowing in foreign currency wherever possible. In some cases, high-return infrastructure projects may require market-related financing (such as for energy, road, and rail projects, and public-private partnerships) and may not be feasible without state guarantees. In cases like this, the government will evaluate the projects on a case-by-case basis, based on their economic rate of return, impact on debt sustainability, and alternatives for achieving the same developmental goals. The government was also required to provide the IMF with a semi-annual listing of projects being considered for market-related foreign financing. On this basis, the government requested that the limits imposed on contracting or guaranteeing new external non-concessional debt under the Fund program be set to accommodate critical infrastructure projects.

The government's debt management strategy in 2015 focuses on providing a more cost-effective access to the international and domestic capital markets to meet the country's development financing needs. The key initiatives to consolidate sustainability and efficiency in debt management include the establishment of a "Sinking Fund" to ensure an orderly redemption of sovereign bonds and other debt instruments; continue with the on-lending to SOEs and the maintenance of escrow arrangements to minimize the impact of loans on the public debt portfolio; and widening the scope of financing opportunities through the issuance of 7-10 year domestic bonds. As part of the government's initiative to consolidate sustainability and efficiency in debt management, creditworthy metropolises, municipalities, districts and assemblies (MMDAs) will from 2015 have the support of the national government to issue municipal bonds to access funding from the domestic capital market for commercially viable projects (IFS, 2014).

Efforts to strengthen the country's debt management capacity were also undertaken, including a publication of a debt management strategy in December 2010 and improvements in analyzing alternative borrowing options, and their cost and risk implications. Guidelines were also prepared and published to help in project selection and appraisal. Consistent with the then ECF program, limits for non-concessional borrowing, and borrowing plans for the key state-owned enterprises were monitored closely, which helped to eliminate data gaps related to SOEs' debts. Furthermore, the Debt Management Division of the Ministry of Finance was reorganized to include units specialized in the functional areas while training was provided to the staff on monitoring and risk-management techniques. Plans were also put in place to monitor domestic debt flows more closely. The good progress made in 2010 as a result of these measures was to be carried over to the following years, particularly given the country's growing access to market financing.

To safeguard the government's overarching goal for debt and fiscal sustainability under the current Fund program, the Ministry of Finance is required to develop a comprehensive Medium-Term Debt Management Strategy and submit to Cabinet for approval by end-June 2015. Plans to deepen the domestic debt market and contribute to reducing refinancing and exchange rate risks, while securing a more stable source of financing over the medium term are to be implemented. The government also intends to strengthen risk management practices by developing an operational framework for building cash buffers, strengthening the management of on-lending portfolios, and reducing the exposure to contingent liabilities by minimizing the use of sovereign guarantees (IMF, 2015). Although Ghana has some flexibility in managing its borrowing at commercial terms, it will be essential that new debts are managed carefully, including extending the maturity of external commercial debt, so that rollover of debts remains manageable.

It is understood that the current IMF Program is fully financed through a combination of external concessional loans and domestic financing, as well as limited non-concessional external borrowing in line with the Fund's applicable debt limit. The Fund's recent DSA indicates that Ghana is at a high risk of debt distress, on account of breaches in the debt-service to revenue ratio over the program period and after 2021. The government is therefore committed to limit its borrowing plans to loans with a minimum grant element of 35 percent, with possible exceptions in line with the debt limits policy. The government has already secured significant program grants and loans from its development partners for 2015, most of which have been frozen since 2013. In addition, the government plans to issue a Eurobond to raise US$1.0 billion during the second half of 2015 as a substitute to domestic borrowing to help repay expensive maturing debt. The Ministry of Finance is also working to identify high priority development projects which cannot be financed by relying only on concessional borrowing. In addition, the Bank of Ghana's gross financing of the national budget for 2015 will be limited to 5 percent of previous year's revenue, using only marketable financial instruments. The rest of the domestic financing of the fiscal deficit will be from deposit money banks and non-banks through the issuance of Treasury bills and bonds. To this end, the government will strive to deepen the domestic bond market with technical assistance from the Fund (IMF, 2015).

3.3 Debt Sustainability Diagnostics

There has been a substantially large build-up of public debt in the country after the HIPC and MDRI in 2006. Ghana's debt sustainability in 2008 was less favorable than in the previous year, reflecting the rise in the debt-to-GDP ratio between end-2007 and end-2008 on account of the large fiscal deficit in 2008. At the same time, and notwithstanding the large fiscal deficit in 2008, the goals of the new government that came into power in January 2009 were more ambitious than those of the previous year. Further, there was a greater assurance that oil production would start in 2011, and this was included in the macroeconomic baseline for the 2009 DSA. The combination of a more ambitious fiscal consolidation over the medium to long term, together with stronger real GDP growth and higher export levels all contributed to a more favorable DSA baseline in 2009 than in 2008. The stress test analysis suggested that the country would remain at a moderate risk of debt distress in 2009 (IMF, 2009).

Despite the debt build-up in 2009-2012, the economy did not show any serious sign of debt distress as the debt-to-GDP ratio was only 48.4 percent as at end December 2012 (Table 4). Moreover, according to the World Bank and the IMF, the projected level and composition of the country's external debt, using 2011 as the base year, showed only a small deterioration in the various debt burden indicators, with all of them remaining below their respective thresholds. As a result, the Bank-Fund standard stress tests for the country showed only a limited risk of debt distress. In addition, over 2009-2012, the macroeconomic fundamentals were right, with interest rates and the cedi exchange rate moving in the right direction and the economy continuing to show strong growth prospects. The strong growth prospects exhibited by the economy during the period were due partly to the expanding infrastructure base which the increased public debt funded. Nevertheless, there is no denying the fact that the debt build-up after the HIPC and MDRI in 2006 was substantially large. And, although the standard stress tests showed that the country was not experiencing any serious deterioration in the various debt burden indicators, continuing the same pace of borrowing in the following years made the debt burden indicators to quickly deteriorate, and thus slowed down the growth of the economy.

Ghana remained at moderate risk of debt distress in 2010 due to improvements in the fiscal performance. The ability to sustain fiscal adjustment in the short term and the potential to accelerate non-oil growth in the medium term contributed to the favorable outcome. Even with oil production, failure to reduce the large primary fiscal deficit and sustain this consolidation over the medium term would result in a much less favorable debt sustainability outlook (IMF, 2011)

Public debt burden trajectories improved in 2011, reflecting more moderate external borrowing assumptions as well as upward revisions to the national accounts. The trajectories of all external debt burden indicators remained well within their respective thresholds, while the overall public debt ratios increased only modestly over the projections period. The external debt burden indicators were projected to remain well below their respective thresholds, provided that the programed fiscal consolidation was achieved and external public sector borrowing was restrained. At the same time, the overall public sector debt was projected to increase moderately in relation to GDP over the long term. If the planned fiscal consolidation was achieved without a substantial further debt build-up, an improved rating of low risk of debt distress was to be expected in future assessments (IMF, 2013). Successful fiscal consolidation was thus crucial for achieving the projected debt outcomes. Without sustained strong growth, debt and debt service ratios were likely to be higher as reflected in some of the stress tests undertaken in the context of public debt. This pointed to the need to use commercial financing to fund new project investments, but if these investments do not deliver a high economic return, then the country's debt vulnerabilities stand to increase significantly.

The debt sustainability analysis for 2013 suggested that the country's risk of debt distress went up, but remained moderate. Driven by the expansionary fiscal policy in 2012, several of the country's public domestic and external debt indicators deteriorated, but the external debt burden indicators remained well below their respective indicative thresholds. The standard stress tests confirmed the moderate risk of debt distress. Though pushed up, all the debt stock indicators as well as the debt service-to-export ratio remained under their respective thresholds even under the standardized stress tests.

Table 4. Ghana: Public Debt Sustainability Profile

Item	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015*
As % of GDP										
Total Public Debt	26.2	31.0	34.8	36.0	38.9	41.6	48.4	55.3	67.1	65.3
External Debt	10.7	15.0	17.4	19.4	20.3	20.8	23.1	26.9	36.6	38.3
Domestic Debt	15.5	16.0	17.4	16.6	18.6	20.8	25.3	28.4	30.5	27.0
As % of Domestic Revenue										
Total Public Debt	191.8	196.9	203.8	234.5	226.0	203.0	280.2	277.0	318.1	
External Debt	78.6	95.4	101.7	126.2	118.9	101.6	133.0	134.6	173.4	
Domestic Debt	113.2	101.5	102.1	108.3	107.1	101.4	147.2	142.4	144.7	
Debt service	38.4	24.5	16.8	20.1	27.6	44.5	43.2	54.4	78.8	
As % of Exports										
Total Public Debt	142.5	177.6	153.2	159.3	150.0	120.1	141.6	171.5	173.1	
External Debt	58.4	86.1	76.6	85.8	78.6	59.9	67.6	83.3	94.4	
Domestic Debt	84.1	91.5	76.6	73.5	71.4	60.2	74.0	88.2	78.7	

*as at end- March 2015

Source: GoG Budget Statement, various sources; Bank of Ghana, Quarterly Economic Bulletin, various issues

Additional risks emanated from the sharp increase in domestic debt in 2013, as reflected in the total public debt for the year. Both the external and domestic debts deteriorated significantly compared with the performances in 2012, with domestic currency debt exceeding the external debt. The standard stress tests confirmed the case for additional fiscal consolidation in the medium to long term to keep public debt sustainable and provide buffers against plausible shocks. The deterioration in the debt indicators relative to exports was driven mainly by a weaker external outlook, while fiscal slippages in 2012 had set total public debt on a less favorable path (IMF, 2014).

The spike in domestic borrowing of the government increased Treasury bill rates and interbank market rates. In the past, similar increases had led to rises in the average lending rates of banks. There was significant risk that short-term interest rates and the resulting cost pressure would push the private sector out of the credit market, particularly the small and medium-sized enterprises. Super-normal returns to government paper had led to super-normal profitability and prevented a rationalization of the sector.

Ghana faced a high risk of debt distress in 2014 and in the first quarter of 2015, as the overall debt vulnerabilities increased, and the country's debt service-to-revenue ratio approached high-risk levels. Driven by loose fiscal policy, deteriorating financing terms and external pressures, several of the country's public domestic and external debt indicators deteriorated. Total public debt service-to-revenue ratio was not only on a rapidly increasing path but had breached its indicative long term threshold. Debt service absorbed a large part of domestic revenue, 23.5 percent in 2013 rising to 32.6 percent in 2014 and 26.5 percent in the first quarter of 2015, leaving the country vulnerable to shocks (IMF, 2015). The external debt service-to-revenue ratio breached and subsequently stayed close to its indicative threshold in the long term. All other debt indicators deteriorated owing to the worsening domestic and external borrowing conditions, weak fiscal consolidation, and a weakening of the domestic currency (Table 4). This analysis does not include the liabilities of the central bank, some of which result from the need to sterilize government financing operations, or the debts of public enterprises that were not guaranteed by the government. Risks could have heightened further as a result of institutional liabilities. Ratings agency Standard and Poor's downgraded Ghana's credit ratings in October 2014 to a level that suggested a low ability of the country to pay its debts on time. Driven by loose fiscal policy, deteriorating financing terms and external pressures, several of the country's public domestic and external debt indicators have deteriorated. As the IMF observed, robust growth and additional fiscal consolidation measures, combined with a more ambitious medium-term adjustment, were required to reduce the risk of worsening debt and debt service indicators.

3.4 Managing the Costs and Risks

There is a real concern relating to the downside risk of the country's debt dynamics and liquidity pressures in the short-term if the current Fund program fails to successfully contain the fiscal deficit, stabilize the currency and address current impediments to higher economic growth. The deteriorating fiscal strength and the adverse debt dynamics fueled by high domestic interest rates and currency depreciation against the major international currencies are extremely disturbing. Without measures to smooth the amortization of the 2013 Eurobond, the 2023 bullet repayment may result in a breach of the indicative external debt service-ratio. The issuance of the 2014 Eurobond at the coupon rate of 8.125 percent could also lead to a breach in three consecutive years in the absence of measures to smooth the amortization profile.

In addition, future financing conditions may be tighter and costly for the country. In its latest World Economic Outlook, the IMF advises sub-Saharan African countries, including Ghana, planning to issue Eurobonds in 2015 to put in place a contingency plan to forestall imminent shocks from exchange rate volatility (IMF, 2015). This concern stems from what the Fund describes as "unusually large" exchange rate movements. Among the major currencies, the dollar has seen a major appreciation (reflecting major differences in monetary policy, with the USA expecting to exit the zero lower bound this year) and the Euro and the yen, a major depreciation. The expected hike in the value of the dollar and interest rates means that it will be more costly to borrow from foreign capital markets especially as the country's currency continues to depreciate against the dollar. This can also lead to a hold-back of huge foreign inflows to the country (see Boah-Mensah and Ashiadey, 2015). Already, it is reported that foreign investors have reduced their holdings in Ghanaian securities by GH₵362 million in the first three months of 2015, making it the second consecutive time in six months that non-resident investors have cut their investments in the country. It is believed that the decline in foreign holdings of Ghanaian securities is due to the weakening investor appetite and loss of confidence for government's debt because of the lingering doubts about long-term macroeconomic stability and public financial management sustainability. Limited fiscal and external buffers in the face of tighter United States dollar liquidity, economic headwinds and terms of trade shocks will also increase the risk for the adverse debt dynamics (Moody's, 2014). It is therefore not surprising the IMF emphasized debt reduction as one of the key benchmarks under the program.

The increased government liquidity risk emanating from the large gross borrowing requirements in the face of more difficult domestic and external funding conditions also poses serious challenges to fiscal consolidation and stability of the external accounts. In particular, the higher than the prevailing risk premia that the September 2014 Eurobond issuance added to the challenges of returning to the international markets ahead of the $530 million Eurobond maturing in 2017, notwithstanding the establishment of a Sinking Fund aimed at assisting with future debt repayments, is worrisome. On the domestic market, large domestic rollover needs and a front-loaded issuance calendar have driven interest rates to over 25% in the short-term Treasury-bill segment. The weighted average interbank rate has been above 23 percent while the average lending rates of banks have remained stable at 29 percent for over a year now. Hence, the proposal to reduce the central bank's support in financing the fiscal deficit to zero over the medium term could be problematic.

The extent of exposure of the country to currency risk can be broadly gauged by the surge in the amount of external public debt it has incurred, in terms of the local currency. At end-December 2008, the outstanding stock of external debt issued or guaranteed by the country amounted to US$4.0 billion, equivalent to roughly 50 percent of the total public debt and 17.4 percent of GDP. By end-March 2015, the external public debt had climbed to US$13.8 billion, reflecting an increase of some 245 percent. This means that the country's external debt increased by 245 percent in dollar terms between December 2008 and end-March 2015, and that 58.6 percent of the total public debt at end-March 2015, equivalent to 38.3 percent of GDP, was exposed to foreign interest rate and currency risks. In cedi terms, however, the country's external debt increased from GH₵4.9 billion in 2008 to GH₵51.6 billion at end-March 2015, indicating an increase of 953.1 percent over the period. The difference between the 953.1 percent increase of the external debt in cedi terms and 245 percent increase in dollar terms reflects the impact of the cedi exchange rate depreciation over the period. Indeed, the cedi exchange rate depreciated slowly from GH₵1.21=US$1.00 in December 2008 to GH₵1.88=US$1.0 in December 2012. Thereafter, the exchange rate depreciated sharply to GH₵3.75=US$1.00 at end-March 2015.

More recently, Ghana's access to the international capital market and the choice of currency and maturity structures of its external borrowings seem to have been driven by the desire to reap immediate fiscal benefits of borrowing in a currency with low coupon rates. Such a debt strategy underestimates the risks associated with unhedged foreign currency borrowing for a number of reasons. First, the capacity of the country to generate foreign currency revenues to repay its obligations is generally limited, as the government's assets consist predominantly of discounted value of future taxes denominated in local currency. Second, it is unlikely that the costs, in terms of output, welfare and reputation that the country may incur in the event of an adverse external shock are fully taken into account in its external borrowing strategy. Although the likelihood of crises is small, their potential disruption to the economy may be substantial. Indeed, a net foreign exchange exposure exacerbates the economic impact of external shocks and limits the policy options available during a financial crisis. With such a large foreign currency exposure, it will be difficult for the country to pursue an expansionary monetary policy during a financial crisis because it will cause a sharp drop in the value of the domestic currency. A depreciation of the currency will worsen the country's indebtedness and risk profile and magnify the financial crisis. In the event of a real exchange rate shock, the government may be faced simultaneously with an escalation of its external debt-servicing costs and a decline in the foreign currency value of its revenues. In addition to the potential capital losses that the government may incur on its debt portfolio, its ability to access international markets to refinance its maturing debt is likely to be limited.

By September 2014, the public debt had reached GH₵69.7 billion or 60.8 percent of GDP, a level considered to be just above the sustainable threshold. As a result, ratings agency Standard and Poor downgraded Ghana's credit ratings in October 2014 to a level that suggested a low ability of the country to pay its debts on time. Driven by loose fiscal policy, deteriorating financing terms and external pressures, several of the country's public debt indicators in 2014 deteriorated. Robust growth and additional fiscal consolidation measures, combined with a more ambitious medium-term adjustment and measures to reduce borrowing were required to reduce the risk of worsening debt and debt service indicators. Despite the need to limit the pace and quantum of borrowing, the government rather added GH₵12.1 billion to the debt stock in the first quarter of 2015.

Since March 2015, the government's three-year and five-year bonds sold to investors did not only fail to raise the required amount but they were sold at very high interest rates. In the last week of May 2015, the government issued a three-year bond to raise GH₵630 million but actually got GH₵572 million. However, the Bank of Ghana took just GH₵502.1 million at the coupon rate of 23.5 percent. In April, the government issued a three-year bond to raise GH₵400 million, but it was seriously under-subscribed. The total bid for the bond was GH₵168 million, of which the Bank of Ghana took GH₵103 million from the investors and paid interest of 22.5 percent. This means that in May, the cost of the three-year bond went up by 1.0 percentage point. A five-year bond issued at the end of March 2015 to raise GH₵400 million also did not perform well. The bid tendered was GH₵610.37 million but only GH₵201.83 was accepted by the Bank of Ghana at the coupon rate of 21 percent. Given that only GH₵210.83 million, representing less than 35 percent of the GH₵610.37 million tendered was accepted, and that the accepted amount was less than the target of GH₵440 million indicates that the risks posed to the economy pushed investors to demand a higher interest rate for the bond. The government has also planned to raise a total of GH₵25.4 billion in domestic loans before July 2015 as stated in the Bank of Ghana's issuance calendar for the year (BoG, 2015). This is twice the amount that the government borrowed through the issuance of securities in 2014. According to the government, besides paying its maturing debts, the loans raised from the bond issuance before July 2015 will also be used to finance its liquidity challenges.

The increased borrowing from the domestic market and the resultant rising interest rates has made the government to allocate huge resources for interest payments at the cost of capital investment. In the 2015 Budget for instance, GH₵8.0 billion has been allocated for the payment of interest on domestic debts, raising concerns that the excessive borrowing and the resultant debt overhang may undermine the government's attempt to implement adjustment programs to promote economic growth because a greater proportion of the domestic revenue to be raised will end up as debt-service payments to creditors. That interest cost in 2014 and the projected amount in 2015 are both higher than capital expenditure in each year seems to suggest that resources are being taken away from several critical sectors of the economy, with serious negative implications for growth. The phenomenal increase in the public debt stock within such short space of time has eroded the fiscal space the country gained through the HIPC debt relief in 2004 and the multilateral debt forgiveness in 2006 when debt was brought down to 26 percent of GDP. The pace of the recent debt accumulation suggests that the country could return to HIPC status sooner than later (IFS, 2014)

4. Maintaining Debt Sustainability: Policy Considerations

Public debt management strategy. As the IFS (2014) pointed out, the 2015 Budget is sketchy and lacks innovative approach to the management of the country's debt. Debt management is more addressed in the Budget in terms of how to maximize borrowing than minimizing the cost of borrowing. The debt management strategy provides for a continuation of cost-effective access to international and domestic capital markets to meet the country's development financing needs. No strategy is provided to manage the high and rising public debt and the associated debt-servicing burden.

The 2015-17 IMF program for its part is equally weak on the approach to the management of the country's mounting public debt. The program only requires the government to limit its borrowing plans to loans with a minimum grant element of 35 percent, with possible exceptions in line with the debt limits set, a policy that is not new to the country. Second, the program requires the Bank of Ghana's gross financing of the budget deficit in 2015 to be limited to 5 percent of previous year's revenue, using only marketable financial instruments. The rest of the domestic financing of the fiscal deficit will be from deposit money banks and non-banks through the issuance of Treasury bills and bonds. To this end, the government will strive to deepen the domestic bond market with technical assistance from the Fund (IMF, April 2015). And from 2016, the Bank of Ghana's financing of the government will be reduced to zero, a policy that appears to be unrealistic. To safeguard the government's overarching goal for debt and fiscal sustainability, the Ministry of Finance is required to develop a comprehensive medium-term debt management strategy and submit to Cabinet for approval by end-June 2015. The government also intends to strengthen its risk management practices by developing an operational framework for building cash buffers, strengthening the management of the on-lending portfolio, and reducing the exposure to contingent liabilities by minimizing the use of sovereign guarantees (IMF, April 2015).

Meanwhile, public debt as a ratio of GDP is not only rising astronomically but has reached a level considered by many analysts to be above the sustainability threshold. The government debt market is also concentrated at the short-term end of the market, putting pressure on the budget from the high rate and high cost of refinancing. The proposal to lengthen the maturity of some of the government debt by issuing long-term debt and finding some funds to pay off the short-term debt is an appropriate one. The government's decision to migrate some commercially viable projects and their associated loans to the management of the Ghana Infrastructure Fund (GIF) is also good as it will lead to a reduction in the government's debt stock. Despite this, the fiscal outlook still poses serious challenges for debt sustainability and the country is likely to be at a high risk of debt distress on account of unfavorable trends in the country's debt service relative to domestic revenues and export earnings.

First, to achieve the medium term debt targets, government will have to adopt a comprehensive debt management strategy that puts caps on the levels of gross concessional and non-concessional borrowing. Limits should also be placed on contracting and/or guaranteeing of non-concessional loans that can become liabilities to the government. To effectively monitor the public debt stance, strict measures and quantitative targets would have to be set to guide the efficient delivery of cash and debt management, suggesting that the plan to review and strengthen the Financial Administration Law and the accompanying Regulations is in order.

Second, in a world of large and volatile capital flows and integrated international capital markets, sound management of the public debt is an important element in safeguarding the country's economic stability. As a first step toward reducing the country's exposure to external shocks, the government should aim at improving the management of the net foreign exchange exposure. The government needs to access international debt markets to offset a shortage of local savings, lengthen the maturity of the country's debt, diversify interest rate risk exposure across various asset markets, accumulate foreign exchange reserves, or develop benchmark instruments enabling domestic private entities to issue bonds abroad. As the international derivative markets have grown in sophistication, the possibilities of hedging risks associated with borrowing in foreign currencies have also greatly increased. The government can therefore respond to the opportunities to exploit market niches and expand its investor base without incurring exchange rate risk. Similarly, the government can use the interest rate swap market to manage the maturity structure of the country's external debt. The amount that can be hedged may be limited, however, because counterparties are usually subject to a ceiling on total exposure to any individual country. The choice of the currency denomination of external debt should also not be driven by the level of nominal interest rates. Instead, borrowing costs should be calculated on a hedged or risk-adjusted basis. Lowering currency risk does not preclude the country from tapping international markets to broaden its investor base, lengthen the maturity profiles, or develop benchmark debt instruments. Rather, it implies that unless the government has access to foreign currency revenues, the country's foreign currency borrowing should, as far as possible, be hedged against currency risks (see Cassard and Folkerts-Landau, 1997).

Third, as debt sustainability depends on both the costs and risks of debt service, defining an effective debt strategy is a difficult task. An effective strategy must choose between domestic debt and foreign debt that strikes the optimal balance between cost and risk. The government will have to assess whether the higher interest rate on domestic debt represents a fair compensation for insurance or a premium for the illiquidity of the domestic market or the exchange rate depreciation that could occur, and whether such expectation is justified or reflects the lack of credibility of the monetary/exchange rate policy. Even more difficult is comparing the expected cost differential of the debt strategies with the risk that they imply, since there is no easy way to quantify such risks and estimate their potential implications for debt sustainability. In fact, debt sustainability analysis tries to evaluate the effects of such risks by "stress testing" the accumulation of debt under alternative scenarios. Unfortunately, the results of such exercises ultimately rely on the probability of the occurrence of different shocks and their relative dimension. This determination remains a matter of personal judgement or, if estimated from past data, is based on faith that the past will repeat itself. The problem that must be addressed is compounded by other dimensions of the debt strategy, which range from the choice of the maturity structure to the indexation of interest payments.

Fourth, the complexity of maintaining debt sustainability has certainly increased together with the sources of financing and the types of instruments that the country chooses to employ. Debt management, however, has gained an increasingly important role in minimizing vulnerabilities to ensure debt sustainability and prevent crises. Risk minimization has also gained increasing support as the main objective of debt management. The government should therefore proceed to deepen the domestic debt market, broaden the investor base and issue fixed-rate long-term bonds denominated in domestic currency, which will provide budget insurance against both supply and external shocks. This greater attention to the insurance role of debt management and the recognition of the importance of sovereign debt structure for crisis prevention should be regarded as crucial to withstand global financial crisis and maintain high growth.

Fifth, greater access to the international financial markets has been bestowed on Ghana and indeed many developing countries, but it has also exposed the countries to the vicissitudes of these markets. The current low international interest rate environment is likely to change not too long in the future, both raising borrowing costs for the country and reducing investor interest, and together with the current slowdown of economic growth, it may be harder for the country to service its debts. In addition to the macroeconomic challenges posed by large and potentially volatile flows, the sizable external foreign currency debt of the country makes it vulnerable to swings in international exchange rates and also to speculative currency attacks. Indeed, prudent macroeconomic policies have at times been compromised by the fiscal consequences of losses associated with these exposures. What is needed is a debt-management strategy and the establishment of appropriate institutions to implement such a strategy.

Institutional arrangement governing debt policy. Limiting the currency risk exposure of the country's debt and lengthening the maturity profile should be viewed as a medium-term strategy and a gradual process. The most critical issue here is the need to reform the institutional arrangements governing debt policy so that the technical expertise and experience required to manage the risks of external debt in a transparent, efficient and accountable manner can be applied. Professionalism and accountability can best be achieved when debt management is assigned to an agency that is separate and autonomous from the political process and to establish benchmarks for the currency composition and maturity structure of public debt, as well as limits on the amount of debt that can be exposed to market risks. Granting a debt agency a separate structure and autonomous status enables the government to charge it with a clearly defined objective and to organize it accordingly, without being hampered by either the management structure or the pay scale of the public sector. The establishment of an autonomous debt agency is justified on the grounds that the agency will have clearly defined performance objectives and a degree of independence from other government objectives. The concentration of resources and expertise in the agency will also result in better risk management and lower debt-servicing costs (see Cassard and Folkerts-Landau, 1997). The agency's main objective will be to fund maturing government debt and annual borrowing requirements at lower costs than the benchmark portfolio while containing volatilities of annual fiscal debt-servicing. Within this framework, the Ministry of Finance will formulate and make public the strategy for debt management while the Debt Management Office will implement the strategy and manage the daily risk exposure of the country's debt portfolio. This type of arrangement will signal to the financial markets and the general public the country's commitment to a transparent and accountable debt management policy.

Domestic versus foreign markets. A major decision that the country faces is whether to fund investment projects and budget needs from domestic or foreign markets. First, the choice between domestic and foreign markets for funding involves a trade-off between costs and risks. The advantage of issuing local currency debt is that it can serve as an effective strategy for the country to reduce its vulnerability to exchange rate valuation effects caused by excessive capital inflows followed by sudden stops and capital reversals. Debt denominated in local currency also increases the policy space because it allows the monetary authority to counter external shocks, such as commodity price shocks or slowdowns in world demand, through exchange rate depreciations without bringing about a sudden jump in the debt-to-GDP ratio and, possibly, a debt crisis. In fact, while currency depreciation is the least painful way to restore external sustainability, this option is precluded or is very costly in the presence of a large share of foreign currency debt. However, the insurance provided by domestic debt does have its drawbacks, as it is costly to obtain, as shown by the higher interest rates that the government pays on domestic bonds relative to those issued in global markets. Furthermore, domestic debt increases the exposure to refinancing risk owing to its short maturity and its vulnerability to capital flights, especially when it is held by foreign investors.

Second, new bond issuances bring both opportunities and risks that the country will have to manage. The low interest rate environment is likely to change at some point—both raising borrowing costs for the country and reducing investor interest—and together with the slowdown of economic growth, this will make it harder for the country to service the debts. Eurobonds may provide a potentially important new source of funding for infrastructure projects, which often require resources that exceed aid flows and domestic savings. However, the foreign currency and rollover risks may have to be considered. Large capital inflows may also lead to undue appreciation of the exchange rate and may create problems for the conduct of monetary policy. The greater risk is that "easy bond financing" may lead to increased public consumption or poor selection and execution of investment projects. More generally, market access to the country raises concerns that borrowing on commercial terms, while increasing the cost of debt service, may not deliver the high growth needed to make the debt sustainable.

Third, the uncertainties and low growth of advanced economies coupled with ample global liquidity in search of higher returns are affecting the cost-risk trade-off that developing countries face in managing their debts. The abundance of global funds is compressing yield spreads, making it easier for developing countries like Ghana to access foreign capital. Low interest rates and the narrowing of bond spreads tend to favor a cost-minimizing strategy by providing developing countries with a strong incentive to fund their debts on international markets. On the other hand, the uncertainty surrounding the monetary policy stance of advanced economies, for example the timing and pace of their exit strategies, and the risks implied by their high levels of public debt could add to financial market volatility and suggest that the greatest benefits come from strategies aimed at minimizing risk.

Financing instruments. Choosing the proper financing instruments is crucial to ensuring debt sustainability. The sources of financing that are currently available to the country are greatly diversified. This provides the country with more financing options and greater opportunities but also poses greater challenges to debt management, particularly with regard to choosing among funding instruments. As the sensitivity of debt service costs to the shocks hitting the economy depends on the composition and maturity of the debt, a long and balanced maturity structure can significantly reduce the risk from interest rate fluctuations. Debt denominated in local currency can avoid capital losses from exchange rate depreciations. Given the broader array of financing sources, the country now faces more trade-offs in defining its optimal funding strategy, as it can choose between domestic and external debt, short and long-term debt, loans and bonds and, between borrowing on concessional and commercial terms. Fiscal sustainability may also be endangered by unexpected deflation to the extent that debt service is fixed in nominal terms, while investment yields real returns. The fact that most shocks to the debt-to-GDP ratio depend on the debt composition suggests that effective debt management can be as important as fiscal policy. This contrasts with debt sustainability exercises that focus on the dynamics of the budget deficit, pointing to the importance of balance sheet effects associated with the debt structure.

Large stocks of foreign reserves and the possible emergence of contingent liabilities also suggest that the country's debt sustainability can no longer be examined with sole reference to public debt; it must also involve the assessment of all assets and liabilities of the public sector. Greater attention to the relation between assets and liabilities in the government balance sheet is critical because it naturally leads to the analysis of debt sustainability, as the costs of debt financing are directly linked to its benefits in terms of investment/asset returns. An asset and liability approach also puts in place a prudential framework to monitor all relevant risks to which the country is exposed, such as commodity price risk, fiscal risk and the emergence of contingent liabilities, in addition to liquidity, currency and interest rate risks.

Use of borrowed funds. The decision on how to use borrowed funds is important to ensuring debt sustainability. At all costs, funds raised by issuing debt should be invested in projects that have a high private or social return. When borrowing in foreign currencies, the country should take great care to ensure that future export revenues will be sufficient to service the additional debt. Clearly, debt accumulation is unlikely to be sustainable if domestic or foreign borrowing is used to finance public or private consumption with no effect on long-term growth. There is no gainsaying the fact that the economy is cash-strapped, and it is obvious that the large fiscal deficit cannot be funded in a manner that does not exacerbate the public debt or cause more inflation and further currency depreciation. The fact of the matter, however, is that, development cannot be justified by high and unsustainable public debt. The country's debt can only be reined in through sustained fiscal prudence to help reduce borrowing. It is important therefore that most of the loans contracted are used to develop the economy to enable it 'grow out of debt.' It will be a fatal mistake to use loans to fund recurrent spending or refinance debts that were used to fund recurrent spending that did not have a direct bearing on growth. But, there are conditions under which even debt used to finance productive investment could turn out to be unsustainable. This happens if the ex-post returns on a project end up being lower than the interest and principal debt repayments. In fact, not only are investment returns difficult to predict, but debt service costs are uncertain. Debt service costs depend on the characteristics of the debt, such as whether debt instruments are denominated in domestic or foreign currency, have a short or long maturity and pay fixed or index-linked rates.

Foreign Direct Investment. While the opportunities and risks implied by commercial loans and portfolio investments and the necessary restrictions to accessing such resources have been highly debated, non-debt-creating capital flows should generally be welcomed by the country. Indeed, over the past two decades, Ghana has experienced a dramatic surge in FDI, which now plays an important financing role. FDI flows do not create debt, but a trade-off emerges between financial soundness and the appropriation of investment returns. The insurance that FDIs provide against debt crises comes at the cost of surrendering a large share of value added to foreign firms. The problem is compounded by the use of fiscal incentives and the concentration of foreign investments into capital-intensive sectors, such as the oil and minerals industry and/or the telecommunications sector, which generate little employment. These implications should also be taken into account by the government in the design of a policy framework for commercial loans that is not unduly restrictive and delivers an optimal financing strategy for the country.

IMF concessionality requirement. Greater access to private foreign capital can bring to Ghana the much-needed resources to overcome the huge infrastructure deficit that is hindering sustainable economic growth. The current policy framework which restricts borrowing on commercial terms by the country, under the IMF program sometimes raises a serious concern as it affects the country's growth and development. Indeed, under the program Ghana must satisfy strong concessionality requirements to continue to receive assistance and in this case a minimum of 35 percent grant element is required on new loans. Coupled with the declining interest rates used to compute the grant element of new loans, the framework severely restricts the country's access to private development finance. There is therefore urgent need for greater flexibility regarding limits on non-concessional loans in the Fund's program, especially if such loans are to be used to finance critical infrastructure and projects that support economic growth.

Co-responsibility of sovereign borrowing and lending. The principle of co-responsibility of sovereign borrowing and lending should be promoted. Ghana should reach an understanding with its lenders on the need to share the responsibility for preventing and resolving unsustainable debt situations. In this respect, the principles on responsible sovereign lending and borrowing formulated by UNCTAD in 2012 should be adopted by the country. These principles clearly specify the responsibility of both sovereign borrowers and lenders to sovereigns by advocating for the use of a good code of conduct and institutional set-up in concluding debt transactions. It would be a big step forward for debt crisis prevention if the country and its lenders could uphold high standards on such aspects as due diligence, transparency and proper approval, among others, instead of succumbing to the temptations of seeking the highest returns and over-borrowing.

5. Conclusion

Ghana's public debt has risen substantially since the HIPC and MDRI debt relief period, triggering a rapid deterioration in the country's debt sustainability and a high risk of debt distress. Total public debt increased by GH₵25.3 billion during the four year-period of 2008 and 2012 and by a whopping GH₵53.1 billion between 2012 and March 2015. This brought the public total debt stock to GH₵88.2 billion at end-March 2015 from GH₵9.8 billion in 2008. Interest payments on the public debt similarly increased from the equivalent of 2.7 percent of GDP in 2009 to 3.4 percent of GDP in 2012, and then jumped to 7.1 percent of GDP at end-2014. This caused interest payments in 2013 and 2014 to exceed their corresponding capital expenditures. The sharp increase in debt accumulation in recent years indicates that Ghana could return to HIPC status sooner than later.

Ghana faced a high risk of debt sustainability in recent years, as the overall debt vulnerabilities increased and the country's debt service-to-revenue ratio approached high-risk levels. Driven by loose fiscal policy, deteriorating financing terms and external pressures, several of the country's public domestic and external debt sustainability indicators deteriorated. Total public debt service-to-revenue ratio was not only on a rapidly increasing path but had breached its indicative long term threshold. Debt service absorbed a large part of domestic revenue, leaving the country vulnerable to shocks. The external debt service-to-revenue ratio breached and subsequently stayed close to its indicative threshold in the long term while all other debt indicators deteriorated owing to the worsening domestic and external borrowing conditions, weak fiscal consolidation, and a weakening of the domestic currency.

The huge surge in borrowing by the country in recent years is attributed to a number of factors, including the rapid economic growth and better economic policies pursued in the country (notably between mid-2009 and the third quarter of 2012), low global interest rates leading to lowering borrowing costs, high global liquidity combined with investors seeking risk-adjusted returns and diversification opportunities. Greater access to the international financial markets did not only provide additional borrowing opportunity for the country, it has also exposed the country to the vicissitudes of these markets and complicated the debt sustainability problems.

With future financing conditions likely to be tighter and costly for the country due to the unusually high exchange rate movements, especially the US dollar, serious concerns relating to the sustainability of the country's public debt and debt servicing costs have emerged. This calls for strong measures to contain the fiscal deficit, stem the depreciation of the domestic currency against the major international currencies, and control the rising domestic interest rates. Maintaining Ghana's debt sustainability will also depend on a multitude of factors that include not only strong and sustained future economic growth but also appropriate borrowing conditions, terms of trade improvement, and reducing foreign exchange and interest rate risks, among others. These considerations call upon the government to pay particular attention to the following issues in its attempts at maintaining debt sustainability. First, the government must formulate and implement a prudent, effective and sound debt management strategy that aims at reducing the country's exposure to external shocks, choosing between the financing sources and instruments in a manner that strikes an optimal balance between costs and risks, and deepening the domestic bond market. Second, there is the urgent need to reform and strengthen the institutional arrangements governing debt policy in the country so that the technical expertise and experience required to manage the risks of rapidly growing public debt can be applied. Third, the government must engage in a more efficient borrowing to ensure that funds are borrowed when they are needed and also invested in projects that have a high private or social return so that the economy can grow itself out of debt. Finally, the government must formulate an international debt workout mechanism that will introduce greater flexibility in the use of non-concessional loans and debt limits usually imposed under IMF programs and also seek to promote co-responsibility of borrowing and lending.

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