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Is Ghana in a Debt Trap?

1.0 Introduction

Ghana's debt stock has increased significantly over the last couple of years with serious implications for effective fiscal management. Total public debt stood at GH₵35.1 billion, or 48.4% of GDP at end-2012 from GH₵9.8 billion in 2008. By end-2016, the debt stock had reached GH₵122.6 billion, or 73.3% of GDP. This means that the total public debt increased by about GH₵25.3 billion in the four years leading to 2012 and by GH₵87.5 billion in the four years leading to 2016. By September 2017, the debt stock had reached GH¢138.9 billion, equivalent to 68.6% of the projected GDP for the year. Adding the ESLA Plc. GH₵4.7 billion bond issued in late October and sale of GH¢5.3 billion long-term bonds at the end of November 2017, of which nearly half consisted of fresh borrowing and the other half treasury bills that were restructured into long-term bonds, brought the total public debt to about GH₵146.2 billion, or 71.7% of GDP at end-November 2017. This made the public debt to increase by about GH₵23.6 billion in the first nine months of 2017. The government also plans to borrow GH₵10.9 billion to finance the projected 2018 deficit of 4.5% of GDP, which will raise the public debt/GDP ratio further if none of the maturing debt is paid during the year, with serious consequences for government interest payment obligations.

External debt has constituted a large portion of Ghana's total public debt since 2014. External debt totaled US$9.2 billion in 2012 and by 2016 it has reached US$16.5 billion, indicating an increase of US$7.3 billion or 79.3% in three years. By

September 2017, Ghana's total external debt had reached US$17.2 billion, implying an increase of US$700 million or 4.2% in nine months.

In tabling the Budget for 2018, the government outlined its strategy to bring the public debt on a declining path to eliminate the risk of debt distress and strengthen the country's debt sustainability. This paper, which is an extract of IFS's review of the 2018 Budget and Economic Policy of the Government of Ghana, provides comments and some policy suggestions to help address Ghana's rising debt problem.

2.0 Government's Response to the Public Debt Albatross

The government plans to reduce Ghana's fiscal deficit from 6.3% in 2017 to 3.8% in 2018 and, over the medium term, generate primary surpluses sufficient to eliminate potential risks of debt distress and strengthen the country's debt sustainability. The strategy also involves a re-profiling of the debt stock to bring down the cost of debt servicing and minimizing refinancing risks. This involves borrowing at less expensive rates to refinance more expensive debt at longer tenor in addition to maintaining a buffer system in accordance with its medium term debt management strategy (MTDMS). To this end, the government issued a new 15-year callable bond, together with a second 7-year bond in April 2017. The proceeds were used mainly to re-profile maturing 91-Day and 182-Day Treasury bills. This consequently led to a change in the short and medium to long-term debt mix, thereby reducing the pressure on the monthly gross financing requirement. According to the government, this liability management program was not expected to add to the public debt stock beyond the net financing requirement for the year. The government maintains that this debt management strategy has improved the country's debt outlook, restored the debt trajectory to a sustainable path and has been instrumental for macroeconomic stability. A major impact of the re-profiling operations has also been a reduction in interest rates and normalization of the domestic yield curve. Also, as it improves on its domestic revenue mobilization and push the primary balance to a higher surplus, the growth of the public debt would decline over time.

According to the government, its debt management strategy for 2018 is consistent with the 2017-2019 MTDMS, which supports a continuation of a fiscal consolidation and monetary tightening policy regime, with a financing mix that minimizes cost and addresses portfolio risks. To support this agenda, the government plans to develop the secondary capital market by creating benchmark securities and operationalizing securities lending and also enter into short-term sale and repurchase agreements to improve liquidity of debt instruments in the market. In view of the refinancing risk associated with repayment of large benchmark securities, the government plans to utilize liability management operations, including switches, buy-backs and reverse-auctions to ensure orderly redemption of these benchmark securities.

3.0 Some Observations

3.1 Debt Distress

Ghana's current debt level is far higher than that of its peers, both as a percentage of GDP and a percentage of revenue. Not only that but also the country's medium-term debt trajectories are on an upward trend, with serious consequences for private sector credit and government interest payment obligations. An analysis of Ghana's debt sustainability by the IMF in August 2017 indicates that the country is at high risk of external debt shocks. The thresholds for the present value of Ghana's external public and publicly guaranteed debt-to-GDP and the present value-to-revenue ratios would be breached for five and two years, respectively. The country's debt service-to-revenue ratio is also projected to stay well above the threshold with an upward shift. The IMF (2016) debt sustainability analysis projects that Ghana's external debt service will continue to stay high for many years, estimated to reach 25% of government revenue in 2035. Ghana is also vulnerable to one-time exchange rate depreciation and a decline in exports, pointing to the need to diversify the economy and increase its resiliency to external shocks. Contingent liabilities, especially from state-owned enterprises and domestic payment arrears also present additional risks to the country's debt sustainability.

According to some analysts, Ghana's debt crisis is the result of a gradual increase in lending and borrowing off the back of the discovery of oil and high commodity prices. More money was then borrowed following the fall in the price of oil and other commodities since 2013 to try to deal with the impact of the commodity price crash while the relative size of the debt also grew because of the fall in the value of the local currency, the cedi, against the dollar. At the same time, the rapid economic growth between 2010 and 2013 led to an increased willingness and desire of various institutions to lend to the country, with a corresponding willingness to borrow (Jones, 2016). Consequently, Ghana's debt increased sharply from GH₵35.1 billion or 48.4% of GDP in 2012 to GH₵122.6 billion or 73.3% of GDP in 2016, indicating an increase of GH₵87.5 billion or 24.9 percentage points of GDP in four years. Surprisingly, when the public debt stock was fast increasing, the GDP was also fast declining, from 9.3% in 2012 to 3.7% in 2016 (see Table 1). The question that arises therefore is, "what was the borrowed funds used for?"

Table 1. Ghana's Pubic Debt Stock.

Item	2012	2013	2014	2015	2016	2017*
Public Debt (GH₵' million)	35.08	53.42	79.54	98.91	122.6	138.9
Changes in Public Debt (GH₵' million)	11.37	18.34	26.12	19.37	23.69	23.60
Domestic Debt (GH₵' million)	18.4	26.7	34.6	40.3	53.4	63.3
External Debt (US$' million)	9.2	11.5	13.9	15.8	16.5	17.2
Public Debt/GDP (%)	48.4	55.3	67.1	71.6	73.3	68.6
External Debt/GDP (%)	23.1	26.9	36.6	42.8	41.4	37.4
Domestic Debt/GDP (%)	25.3	28.4	30.5	28.8	31.9	31.3
Addendum Item						
Real GDP Growth	9.3	7.3	4.0	3.8	3.7	8.4

Source: Bank of Ghana. Summary of Economic and Financial Data (various issues). *as at September

A combination of commodities price fall and loans not being used well enough to ensure that they could be repaid has now pushed Ghana back into debt crisis. In early 2013, the price of gold dropped significantly, as did the price of oil from the middle of 2014. Between 2013 and 2016 the value of the cedi against the dollar fell by 55.3%, causing Ghana's GDP denominated in dollar to fall from US$42.5 billion to US$39.8 billion. This, in turn, increased the relative size of the country's external debt and debt payments. External debt increased from US$11.5 billion in 2013 to US$16.5 billion in 2016, indicating an increase of 43.5% during the period. As a percentage of GDP however, the external debt increased from 26.9% in 2013 to 41.4% in 2016 due to the depreciation of the domestic currency (See Table 1).

3.2 Rising Interest Cost

Interest payment on government debt has increased significantly in the last few years due to increased borrowing, posing a serious problem for fiscal management. As shown in Table 2, interest payment increased from GH₵2.44 billion in 2012 to a provisional figure of GH₵13.28 billion in 2017, representing an increase of 444.3% during the period. Interest payments is projected to increase to GH₵14.9 billion in 2018, which will represent an increase of GH₵12.46 billion or 510.1% from end 2012. Interest payment on public debt alone will consume 37.4% of tax revenue in 2018 down from 41.8% in 2017. Interest payment will also account for 24.6% of total government expenditure in 2018, from 25.8% in 2017. In fact, 2017 was the fourth successive year that total interest payments was larger than total government capital expenditure. This suggests that interest payments will probably be financed through additions to public debt or at the expense of other key government expenditures. According to Fitch Ratings (2015), the country's interest burden is the highest amongst its peers in sub-Saharan Africa. Many analysts describe the escalating interest on the country's debts as worrying.

Table 2. Ghana's Pubic Debt-Servicing Cost

Item	2012	2013	2014	2015	2016	2017*
Interest Payment (GH₵' million)	2.44	4.40	7.08	9.30	10.70	13.28
Interest Payment/GDP (%)	3.5	4.7	6.2	6.8	6.4	6.5
Interest Payment/Total Expenditure (%)	11.8	16.0	22.0	24.1	21.2	25.8
Interest Payment/Tax Revenue (%)	19.5	30.7	36.8	40.2	38.6	41.8

Source : IFS (2018). *projected for end-November

Ghana's rising interest cost cannot be stemmed through debt re-profiling as the government's debt management strategy seems to suggest. The biggest gain to the re-profiling of the public debt is the extension of the maturity periods which would give the country a breathing space to mobilize funds to pay the debts. Interest gain, if any, will depend on the rates and maturity periods of the debts before and after the re-profiling exercise since the size of the debt itself would remain the same. Proactive debt management strategy is therefore needed to reduce interest payments and mitigate risks to the public debt profile. The government needs to formulate an annual borrowing plan, improve treasury management and forecasting, enhance debt reporting, and strengthen operational risk management. To attenuate the risk of contingent liabilities, the government must monitor closely all debt issued by the state agencies, subnational authorities, and state-owned enterprises. Implementation of interest rate hedging which would allow for enhanced predictability of debt-service will also help in stemming the rising interest costs.

3.3 Fiscal Adjustment

Ghana's large debt financing needs represent a key source of vulnerability, especially on the external front. The large share of foreign currency debt in total public debt at non-concessional terms exposes the country's debt dynamics to foreign exchange shocks and also to a tightening of external liquidity conditions. Given the increasing share of nonresidents' investors in the domestic debt market, restoring and maintaining debt sustainability is hinged on credible and sustained fiscal consolidation to anchor investors' confidence in the economy. This will need to be supported by appropriate debt management strategy and broad structural reforms to ensure higher and inclusive growth. A gradual fiscal adjustment will help improve the public debt outlook, without protracted breaches of the public debt benchmarks. On the revenue side, there is the need to broaden the revenue base to include the informal sector, review the extractive industry fiscal regime, and strengthen the machinery of tax collection and administration.

The collection, use and accountability of internally generated funds by public institutions and agencies should be given serious attention. The assessment, collection, use and accounting for oil revenues must also be subjected to regular public accountability. On the expenditure side, strengthening the wage bill control measures to address the ghost names payroll fraud albatross is required. The starting point is to deal seriously with the revelations of misappropriation, waste and embezzlement uncovered in the various Auditor-General's reports. Further reviewing the statutory funds to allow for realignment to government priorities must also continue as serious questions about the funds accountability, priorities for spending and administrative expenditures continue to exist. Extravagant spending on goods and services by MDAs, especially on vehicles, must also be stopped. In a nutshell, a realistic fiscal plan that seeks to clean up the government's accounts and build confidence in sound management is what is required.

4.0 Conclusion

Ghana has fallen into a debt trap as real interest rates continue to surpass GDP growth rates. The country's debt/GDP ratio has exceeded 70% in the last few years, pushing it into a serious debt distress. This has made the country to continue committing more of its tax revenue to service debts. Indeed, in 2016, the government spent GH₵10.7 billion, equal to 38.6% of tax revenue to service its debt. In the revised 2017 budget, the government set aside GH₵13.3 billion, equal to 41.8% of tax revenue for interest payments.

The 2018 budget also makes a provision of GH₵14.9 billion, equal to 37.4% of the projected tax revenue for interest payments. These huge interest payment provisions were made because the country has been able to borrow more and used part to service its debt whilst the overall size of the debt increases. With a large part of the country's debt being accumulation of external liabilities, the question that also arises in addition to the ability to repay is whether foreign lenders would be willing to continue to lend to the country. Indeed, it is a misnomer for a country with a huge infrastructure deficit and pressing social needs, especially education and health, to spend over 37% of its tax revenue to service public debt.

In recent studies on Ghana's debt by the Institute for Fiscal Studies (IFS), a number of measures were suggested to help maintain the country's debt sustainability. They include the need for a 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. The government also needs to formulate and implement a prudent, effective and sound debt management strategy, balance the choice of financing sources and instruments, engage in responsible borrowing by using borrowed funds to invest in projects that have a high private or social return, and formulate an international debt workout mechanism to address fully the problems posed by the unsustainable public debt and their implications for effective fiscal management (See IFS, November 2015; December 2015). The rate of increase in interest payment also has to be looked at critically by the government by ensuring that the rate of debt accumulation is reduced and borrowing be done at low rates. A serious reprioritization of government expenditure and the pursuance of a stronger domestic revenue mobilization along with a proper financing mix is also needed to avoid jeopardizing the sustainability of the country's debt.

The IFS also fully supports the following measures proposed by Jones (2016) to help Ghana avoid a protracted and damaging debt crisis:

i. The need to establish an independent debt audit commission, made up of domestic and international experts, to conduct an audit to reveal publicly how much debt there is for Ghana, who are the creditors, what were the funds and on what terms;

ii. Government should hold a debt conference with all creditors, including the World Bank and IMF, with the aim of agreeing burden sharing to bring debt payments down to a sustainable level;

iii. Government should consider re-introducing the rule that prevents cedi-denominated domestic loans being bought by foreigners, thereby establishing a clear distinction between domestic and external debt; and

iv. Government should consider defaulting on private debt which speculators lent irresponsibly and on which significant interest has already been paid or simply cancel unjust debt.

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