The Challenges of Debt Sustainability in Africa

African Forum and Network on Debt and Development

The Case of Ghana

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AFRODAD Vision

AFRODAD aspires for an equitable and sustainable development process leading to a prosperous Africa.

AFRODAD Mission

To secure policies that will redress the African debt crisis based on a human rights value system.

AFRODAD Objectives include the following:

1 To enhance efficient and effective management and use of resources by African governments;

2 To secure a paradigm shift in the international socio-economic and political world order to a development process that addresses the needs and aspirations of the majority of the people in the world.

3 To facilitate dialogue between civil society and governments on issues related to Debt and development in Africa and elsewhere.

From the vision and the mission statements and from our objectives, it is clear that the Debt crisis, apart from being a political, economic and structural issue, has an intrinsic link to human rights. This forms the guiding philosophy for our work on Debt and the need to have African external debts cancelled for poverty eradication and attainment of social and economic justice. Furthermore, the principle of equity must of necessity apply and in this regard, responsibility of creditors and debtors in the debt crisis should be acknowledged and assumed by the parties. When this is not done, it is a reflection of failure of governance mechanisms at the global level that protect the interests of the weaker nations. The Transparent Arbitration mechanism proposed by AFRODAD as one way of dealing with the debt crisis finds a fundamental basis in this respect.

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AFRODAD is governed by a Board of seven people from the five regions of Africa, namely East, Central, West, Southern and the North. The Board meets twice a year. The Secretariat, based in Harare, Zimbabwe, has a staff compliment of Seven programme and five support staff.

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Preface

The World Bank (WB) and the International Monetary Fund (IMF), as the leading lending agencies, have been under mounting pressure to deal with a wide range of debt sustainability challenges. The challenges have refused to subside. Instead they continue to stimulate urgent need for a new debt sustainability framework and debt management orientation that can allow for the borrowing economies to break the vicious circle of unending distress. The Heavily Indebted Poor Countries (HIPC) framework and the 2005 G8 Debt deal which is generally a compromise of the US and UK proposals are yet to shake down into a coherent strategic compact (with the poor countries of the borrower economies) capable of addressing unsustainability challenges facing the debt burden of all the poor economies of the South.

In the recent past; the Bank and the Fund have paradoxically demonstrated a generous willingness to admit the 'systematic over-optimism' of the previous International Financial Institutions' debt sustainability calculations and measures. From time to time, creditors have however, failed to put sufficient political will, resources and serious analysis into the debt reduction operations. Debt reduction targets are set and reset arbitrarily - writing off 30 percent, then 50 percent, and so on-rather than based on serious assessments of the needs of each country.

In order to operationalize debt sustainability existing frameworks such as HIPC and the Country institutional Policy Assessment (CPIA) need a revisit. One way of looking at resolving the Third World debts would be by first securing an agreement on the working definition of debt sustainability. This implies revisiting the concept of debt sustainability as given by the IMF, identifying its short-falls and seeking ways of redressing them so as to enable the initiative to work better for the poor countries. In so doing, the issues of both domestic and external debt, conditionalities, domestic revenue as well as the role of external shocks in the fiscal and monetary policies of the poor country become very important.

This case study looks into the debt sustainability issue taking cogniscence of the domestic debt issues facing the African government (s) at national level. It argues that debt sustainability should not be defined as just meeting the debt indicators as given by the international financial institutions, but it should help the country to break from its debt burden-both external and domestic and be on the path to development. Thus the study among other things advocates for a holistic definition of debt sustainability and the agreement on indicators that a developing country is comfortable to work with than just focusing on of exports earnings to the net present value of all future debt servicing payments. In short, Debts are should be considered 'sustainable' when the debt service burden leaves the Low income countries (LICs) with sufficient funds to meet their human rights obligations under the internationally agreed Millennium Development Goals (MDGs).

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List of Acronyms/Abbreviations

AAP	Assessment Action Plan
AfDB	African Development Bank
AfDF	African Development Fund
APR	Annual Performance Review
BOP	Balance of Payments
CAS	Country Assistance Strategy
CCS	Commitment Control System
CDD	Centre for Democratic Development
CDS	Country Development Strategy
DSA	Debt Sustainability Analysis
DSF	Debt Sustainability Framework
ERP	Economic Recovery Programme
ESAF	Enhanced Structural Adjustment Facility
FDI	Foreign Direct Investment
G8	Group of Eight Highly Industrialised Countries
GDP	Gross Domestic Product
GPRS	Growth and Poverty Reduction Strategy
GPRSP	Growth and Poverty Reduction Strategy Paper
HIPC	Highly Indebted Poor Country
IADB	Inter-American Development Bank
IBRD	International Bank for Reconstruction and Development
ICOR	Incremental Capital Output Ratio
ICSID	International Centre for the Settlement of Investment Disputes
IDA	International Development Association
IMF	International Monetary Fund
I-PRSP	Interim Poverty Reduction Strategy Paper
MDA	Ministries, Departments and Agencies
MDGs	Millennium Development Goals
MDRI	Multilateral Debt Relief Initiative
MTEF	Medium Term Economic Framework
NDC	National Democratic Congress
NGO	Non-Governmental Organisation
NPP	New Patriotic Party
NPV	Net Present Value
ODA	Official Development Assistance

ODI	Overseas Development Institute.
PEAP	Poverty Eradication Action Plan
PEM	Public Expenditure Management
PFM	Public Financial Management
PHDR	Poverty and Human Development Reports
PNDC	Provisional National Defence Council
PRGF	Poverty Reduction and Growth Facility
PRS	Poverty Reduction Strategy
PRSP	Poverty Reduction Strategy Paper
PSI	Policy Support Instrument
SAP	Structural Adjustment Programme
SAPRI	Structural Adjustment Participatory Review Initiative
SAPRIN	Structural Adjustment Participatory Review International Network.
SDR	Special Drawing Rights
SSA	Sub-Saharan Africa
UNCTAD	United Nations Conference on Trade and Development
UN	United Nations

Executive Summary

This paper examines in broad terms concerns surrounding the prevailing debt sustainability framework in Africa generally and in Ghana specifically, by analysing the efficacy or otherwise of the debt relief initiatives and mechanisms, designed to reduce debts to sustainable levels. It begins with a review of the two main vehicles of debt reduction in heavily indebted and poor countries - the Heavily Indebted and Poor Countries (HIPC) Initiative, and the Multilateral Debt Relief Initiative (MDRI), - using available literature on subject matter. It critically analyzes the basic assumptions of Ghana's debt sustainability framework and challenges these assumption based on Ghana's historical performance.

Ghana's HIPC Experience

The end of the commodity boom in the mid-1960s and the mismanagement of the giant state-owned agricultural and industrial schemes combined to quickly drain Ghana's foreign exchange reserves, forcing the government to resort to supplier credits to finance many projects. Then the 1973-74 and 1979 oil price hikes took a heavy toll on Third World non-oil producing economies, including Ghana's. As macro-economic instability set in, the economy continued to rely on massive injection of foreign capital, especially from the IMF and the World Bank. The precarious nature of the economy made Ghana in 1983 to accept to undergo structural adjustment reforms. Structural adjustment itself was flawed in many respects. The assumption that a cocktail of liberalization, privatization, getting prices right, exchange rate reforms and smaller government (in short, a market economy) would engender growth and eradicate poverty was found to be false. Inflation rates began to rise after 1992, reaching an average of 59% in 1995. Indeed, it was these revealing fiscal and monetary crises that unveiled the major shortcomings of macroeconomic reforms, the inability to diversify successfully the structure of the economy and the continuing dependence on massive injection of external inflows, the combination of which exacerbated poverty within the economy and created the platform for accession to the HIPC initiative. By the close of the end of 2000, Ghana's total external debt stood at $ 6.7 billion.

Debt Sustainability Analysis

The research is able to make the following broad conclusions.

- Ghana has made tremendous strides since accessing the HIPC Initiative. Prudence in economic management and strict adherence to the demands of the HIPC has enabled Ghana to enjoy considerable relief. Overall, Ghana has received $4,429 million in total of debt relief, made up of $1,446 million of HIPC relief from the IDA and $2,983 million MDRI write offs.
- Propped by space created from debt relief and supported by rise in cocoa and gold prices, Ghana's economy has seen marked improvement as borne out by macroeconomic indicators. Domestic debt-to-GDP ratio has fallen to 8.7% in 2006; overall budget deficit as a percentage of GDP is only about 2.1%. Year on year inflation has fallen to 10.5% and there has been a phenomenal increase (400%) in balance-of-payment (BOP) surplus. GDP growth reached a remarkable 6.2% in 2006.
- Ghana's fiscal vulnerability is declining due in part to the Multi-Donor Budgetary Support (MDBS) and in part to the substantial increase in public revenues and expenditures. Total government receipts have increased in real terms by 159% within seven years rising from 18% of GDP in 1999 to 24.1% in 2006. This increase has been achieved mainly from domestic revenue. Revenue-enhancing measures as well as improved tax administration, coupled with greater collection of internally generated funds and higher levels of remitted profits account for this achievement. Such increases in domestic revenue have enabled government to reduce reliance on aid receipts.
- Subjecting Ghana's debt to sustainability analysis, using IMF scenarios and other vulnerability tests, it may be said that Ghana's debt is sustainable. However, under stress tests, specifically, volatilities in world oil prices, domestic energy and water crises, as well as demand for wage rise, and not discounting the general temptation to expand broad money, indications are that sustainability may be a difficulty in the long run.

Challenges to Debt Sustainability

The research has uncovered some areas of concern.

- There is a need to think more broadly about what debt sustainability entails, given the current development framework. Treating external and domestic debt separately doesn't give adequate attention to the fiscal space that is needed to finance the MDGs. However, the need to access international markets is based on Ghana's desire to meet its development targets. The GPRS II estimates that a resource envelope of US$8.6 billion is required to do so; indicating an overall funding gap of $1.79 billion.
- The ratio of payments on domestic debt as a proportion of domestic revenues captures the budget sustainability of the debt burden. Given that donor grants are not significant to cover the fiscal shortfall, the tendency towards domestic financing is strong. The ratio of domestic debt to total revenues has nearly doubled between 2006 and 2007.
- There is perhaps an over-emphasis on projected values (government revenues, export growth, etc.). A country's past and current performance is the best indication of how it will fare, given the projected expenditures it must undertake. For example, the baseline projects 7% GDP growth until 2011, but Ghana has never recorded 7% growth, going as far back as 1996.
- Ghana being a natural resource-intensive economy, external shocks would most likely result from changes in commodity prices, lowering the expected amount of foreign capital reserves. Commodity price indices tracked by UNCTAD reveal that cocoa prices have become more variable in recent years, with the standard deviation between 1960 and 2004 being 9%; 49% between 1980 and 2004; and 66% between 1995 and 2004. A fall in the price of cocoa would indeed inhibit Ghana from making its currently exorbitant external debt service payments ($4,537.4 billion cedis in 2006), while having contracted new loans amounting to 5,383.4 billion cedis in the same year.

1.0 Introduction

The commodity boom in the 1960s and the political and economic demands of the post-independence era provided impetus for African countries to accept loans for development. In the context of the Cold War, and with massive revenue surpluses of oil money (*petro-dollar*, as it was then called) in Western banks in the 1970s, loans were made with little thought to their purpose or their recipients' capacity to repay them. Much of the loans were used to set up an amenable environment for foreign interests and/or contributed to the private wealth of African leaders.

The debt crisis in the developing world began to unfold in the 1980s, when the shocks of the 1970s oil crisis, rising interest rates, and a fall in global prices for primary commodities began to take a toll. Sub-Saharan Africa (SSA) saw such unimaginable stagnation, decay, and decline that the World Bank had to intervene through the setting up of the Elliot Berg Commission[1]. For instance by 1979, Africa's GDP growth was negative 1.9%. The foreign debt of SSA to its gross national product (GNP) rose from 51% in 1982 to 100% in 1992[2]. By the mid-1990s, Africa's debt burden was twice that of any other region in the world, with SSA the worst off. SSA owned only 5% of the developing world's income, but carried nearly a third of its debt[3].

It was in this context that Structural Adjustment (as proposed by the Berg Commission Report), was adopted as a way to prepare the debtor countries to be part of the global liberalised economy. Structural Adjustment emphasised liberalisation, privatisation, exchange rate reforms, smaller governments, and withdrawal of subsidies. It encompassed a number of policy reforms, for which the resulting macroeconomic stability envisaged would engender growth and, by that, ensure debt repayments. Growth, by itself, was thought to be able to reduce and/or eradicate poverty.

Structural Adjustment Programmes (SAP) were among the many traditional mechanisms targeted at debt relief and sustainability. Generally, the traditional mechanisms have the following components:[4]

- Flow rescheduling arrangements with Paris Club creditors on concessional terms in support of the above adjustment programmes, but this is contingent upon a clean health bill from the IMF
- Debtor-country to seek comparable terms on debt owed to non-Paris Club bilateral and commercial creditors facilitated by the International Development Association (IDA)
- Bilateral forgiveness of Official Development Assistance (ODA) debt by many creditors, and
- New financing on appropriately concessional terms

Although this kind of approach ensures both new concessional financing and debt relief at the same time, it is flawed in many ways. In the first place, the specificities (e.g. external position) of debtor countries differ from country to country in several important respects. For example, a survey by Boote and Thugge in 1994[5] revealed that current account for some debtor countries was in surplus, while for others deficits exceeded 100% of exports. Also scheduled debt service obligations varied widely – from less than 20% of exports for some countries to more than 100% for others. They also noted that the actual debt service paid ranged from 5% of exports to as high as 50%. Additionally, the indebtedness by the developing countries was to equally varied creditors; Paris Club bilateral creditors, Non- Paris bilateral creditors, commercial banks, and multilateral institutions. These and many more were the issues which SAP failed to take into account and which thus created conditions for more debt accumulation by the developing countries, including Ghana.

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[1] It was the Elliot Berg Commission that proposed Structural Adjustment Programmes (SAPs) as the only panacea to ailingThird World economies.

[2] Alternative Information and Development Centre (htt://www.aidc.org.za) (accessed 22/02/08)

[3] Sandford, Jonathan E., "Africa's Debt Burden: Proposals for Further Forgiveness", *CSIS Africa Notes, October 1996, in Promoting US Economic Relations with Africa,* Task force report, by the Council on Foreign Relations, 1998.

[4] For an in depth analysis of this, see Boote, Anthony R., and Kamau Thugge, *Debt Relief for Low-Income Countries : the HIPC Initiative*, Washington, DC: IMF, Pamphlet Series No. 51, 1997.

[5] *Ibid*. p.2

The negative results of the traditional debt–management arrangements created the platform for rethinking the problem of debt-management in the debtor countries. Strong agitation had come from civil society, which saw debt-management schemes as ethno-centric and non-transparent (non-participatory). The open admission that structural adjustment had not yielded the anticipated results also lent support to the call for a paradigm shift in debt-management.[6] Indeed, HIPC is a veritable indictment of structural adjustment.

1.1 The HIPC Initiative

The inability of such mechanisms to relieve the developing countries of debt burdens caused the inception of the Highly Indebted Poor Country (HIPC) Initiative. The HIPC Initiative is an arrangement, in which a country with a higher than sustainable debt obligation engages in a joint project with the major multilateral creditors to reduce its debt burden and to tackle poverty, and, at the same time, ensure growth and development. Moreover, it was the realisation that the HIPC initiative lacked the bite to redeem the developing countries of the debt burden which triggered the Multilateral Debt Relief Initiative (MDRI). Of prime importance in all these was the point of ensuring not only debt reduction and alleviation of debt service, but also growth and development in such a way, that future generations would not be saddled with further debt burdens.

Bird (1989) traced the causes of the debt trap for developing countries and the economic implications for both debtor and creditor nations. According to him, borrowers with a rising savings ratio, a low and falling incremental capital-output ratio (ICOR), rapid export growth potential relative to import growth, and paying relatively low interest rates should encounter few debt problems. Bird underscores the fact that most highly indebted countries have falling savings ratio, high and rising ICORs, low export growth, little scope for import substitution, and they also pay relatively high interest rates. Of interest is Bird's lamentation not only on capacity for debt management in the debtor countries, but also on the ineffectiveness of policies for dealing with debt.

According to Bird, this scenario created the burdensome situation in the 1980's such that debt/export ratio of developing countries rose very fast. Bird observed that for 21 least Developing Country (LDCs) borrowers, the debt/export ratio rose from less than 125% in 1980 to nearly 180% in 1982. For Bird, policies for dealing with debt, which mainly had consisted of market solutions, economic adjustments in debtor countries only, and rescheduling have not proven to be sustainable. With galloping debt and debt servicing ratios, and a rather dwindling real per capita income growth, low investment ratio, as well as dwindling export volume growth in the debtor countries, Bird suggests a combination of adjustments, financing, and debt forgiveness. The HIPC initiative and the MDRI seem to give this cocktail prescription of Bird.

The HIPC Initiative was thus launched by the IMF and the World Bank in 1996 with the objectives of eliminating the debt overhang for countries designated as HIPC, reducing multilateral debt, and helping countries exit from endless debt restructuring to sustainable debt positions. The HIPC initiative constituted a radical departure from previous arrangements, because for the first time in the history of debt relief, it included cancellation of debts owed to multilateral institutions (such as the IMF, the World Bank, and IADB).

There are three main criteria for HIPC Initiative eligibility. A country had to be eligible only for concessional loans from the International Development Association (IDA) and the Enhanced Structural Adjustment Facility (ESAF) of the World Bank, since renamed the Poverty Reduction and Growth Facility (PRGF). Secondly, a country had to have a debt burden that was considered "unsustainable". A sustainable level of debt was gauged to be a debt-to-export ratio between 200 and 250%, (D/X e" 200 – 250%) and a debt-service to export ratio between 20 and 25% (DS/X e" 20-25%). In other words, "sustainable" debt should not exceed two and half times the value of exports, and that debt service should not exceed a quarter of the value of exports.

[6] The former President of the World Bank, James Wolfensohn, in a letter dated April 9, 1996 to the global civil society, Structural Adjustment Participatory Review International Network (SAPRIN), noted "Policy reform has had a mixed track record. Adjustment has been a much slower, more difficult and more painful process than the Bank recognized at the outset." See the *Policy Roots of Economic Crises and Poverty: A Multi-Country Participatory Assessment of Structural Adjustment*, Washington DC, SAPRIN, 2002. Others who have seriously criticised the Structural Adjustment philosophy include Joseph Stiglitz (See his book *Globalization and Its Discontents*)

A country had to establish a track record of economic reforms under World Bank and IMF-sponsored programmes. The main prerequisites to being eligible for debt relief under HIPC were that a country must be facing an unsustainable burden of debt, beyond traditionally available debt relief mechanisms such as the Paris Club; a country must establish a track record of reforms (or must be prepared to undergo such reforms) and sound policies, supported by the World Bank and IMF; and a country must prepare a Poverty Reduction Strategy Paper (PRSP).

The eligibility criteria and the attendant conditions are operationalized by a three-step process which involves an eligibility point, a decision point, and a completion point.

There is a three-year period between the "eligibility" (entry) point and the "decision point", during which a country followed the IFIs adjustment programmes, and at the end of which the country is subjected to a debt sustainability analysis to see whether and to what degree the country required debt relief. It is the period when the country demonstrates some progress towards adjustment and reform programmes and submits a first draft of its PRSP. [7] At the decision point the multilateral institutions that are granting debt relief formally decide on the country's eligibility, compute a sustainability threshold, and commit to reducing the debt to this threshold. After the decision point, the country starts receiving interim debt relief. After a second three-year period during which the country would consolidate its track record in following IFI programmes, the "completion point" would be reached, and the country would then receive the full debt relief committed to at the decision point.

Throughout the structural adjustment period the sensitivity of export supply to price was found to be varied in various countries.[8] Therefore, the blanket formula and exchange rate reform (devaluation) as critical component of the structural adjustment programme was not found to be uniformly possible. In Ghana, (one of the most touted "star performers" of structural adjustment), for instance, substantial realignment of nominal exchange rates was noted not to have had any significant impact on export volume. The export response of Ghana's manufacturing sector apparently depended on factors additional to exchange rates.[9]

However, some countries would have close to 80% of their debts still haunting them even after reaching the completion point. While some blamed the situation on the level of bureaucratic detail involved in qualifying for HIPC relief, others blame it on economic and structural bottlenecks within the HIPC countries.[10] Criticisms of the pace and eligibility criteria as well as the appalling results of the initial countries led to a revision of the initiative and the inception of the Enhanced HIPC Initiative at the G8 Summit in Cologne, Germany, in 1999. The leaders of the G7 countries also committed themselves to writing off an additional $100 billion of the HIPC countries debt. Under the framework, debt relief was to be made "broader, faster, and, deeper", and it was to be linked more closely and transparently with the goal of poverty reduction – a kind of pro-poor development paradigm. The Enhanced HIPC PRSPs were to be developed transparently through a government-led national process, in consultation with civil society, the private sector, and the external donors, and with assistance from the World Bank and IMF. The aim then of a PRSP would be to ensure country ownership of programmes. It also ensures consistency between a country's macro-economic, structural and social policies, and the goals of poverty reduction and social development.

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[7] A satisfactory Poverty Reduction Strategy Paper (PRSP) could be in the form of an Interim PRSP, PRSP preparation status Report, full-PRSP, or Annual Progress Report (APR)

[8] A most profound assessment of the Structural adjustment Programme has been given by the Structural Adjustment Participatory Review International (SAPRIN). See their publication already referred to.

[9] *ibid*. p48

[10] The former position is represented mostly by non-governmental organizations. An April 2001 report from Jubilee 2000/UK, for instance, in its ***Drop-the–Debt Campaign*** alleged that the HIPC process had brought a mere 27% reduction in average annual debt payment to the 22 countries that had begun to receive debt relief and the total value of this was $735million per year. They concluded that the HIPC Initiative was unlikely to provide a country with a lasting exit from its debt crisis or sufficient resources to tackle poverty unless it achieved strong, sustained economic growth and also continued o borrow at the same level and concessional terms as before. See their position and others in (i) Jubilee 200/UK Presentation, "The Need for further Enhancement of the HIPC Initiative", Bretton Woods Committee Roundtable, Washington, DC November 2000; (ii) Drop The Debt, "Reality Check. The Need for Deeper Debt Cancellation and the Fight against HIV/AIDS, April 2001. (iii) See also Oxfam International Briefing Paper, "Drop the Debt-Go Back to First Principles", July 2000. The latter argument had mostly come from intellectuals. See for instance, Sachs, Jeffrey D., "The Charade of Debt Sustainability," The Financial Times, September 26, 2000.

In any case by 2005 the debt situation had only improved marginally, prompting the G8 Summit of that year in Gleneagles, Scotland, to rethink the question of HIPC and debt relief. It must be noted that prior to this, ex-British Premier Tony Blair, had initiated moves, through the inception of the Commission for Africa, towards the total liquidation of the African debt and for poverty eradication. In his speech at Gleneagles, therefore, he called for the setting up of an International Finance Facility (IFF) amounting to $55 billion for this purpose. The response of other donor countries was rather unfavourable.

The Gleneagles Summit decided to look beyond Tony Blair's proposals with a more comprehensive outlook on debt management and beyond the HIPC. The G8 leaders pledged to cancel the debt of the world's most indebted poor countries, most of which are in Africa.

Their proposal required full (100%) debt cancellation by three multilateral organisations: The International Development Association (IDA) of the World Bank, the International Monetary Fund (IMF), and the African Development Fund (AfDF) to countries that have reached the 'completion Point' under the HIPC Initiative.[11] In other words HIPC countries that had reached the 'completion point' would be eligible for additional debt relief under the MDRI. This gesture by the G8 enjoined the above-mentioned multi-lateral institutions to cancel 100 percent of their claims on HIPC countries in order to free resources for attaining the Millennium Development Goals (MDGs). The overall cost of the MDRI to the multilaterals is estimated at $47.9 billion in nominal terms, which is additional to the HIPC Initiative debt relief.

The IDA, IMF, AfDF, and the IADB have provided approximately 69, 9, 15, and 7 percent of the total MDRI debt relief, respectively. MDRI assistance already delivered to completion-point HIPC is estimated at $37.6 billion in nominal terms.[12]

Some pessimism about the efficacy of the HIPC initiative and the MDRI has been expressed most recently by Todd Moss.[13] Finances, according to Moss, are rarely the binding constraint on poverty and other development outcomes. Most debt problems, especially Africa's, are mainly the result of slow economic and export growth, combined with the perverse effect of the international aid system. Even though countries borrow on soft terms, they are still unable to repay the loans because the investments never produced the expected gains. While accepting that the HIPC and MDRI could have positive and considerable impact over the long term, Moss also contends that expectations of the effect on indebted countries and development indicators should be kept modest and time horizons long.

Moss' pessimism is rather a kind of cautious optimism. The rise of debt ratios in many debtor countries (debt stock/GNI or debt service/exports) is in many ways not so much a problem with the numerators growing too fast as it is of the denominators growing too slowly (or for many countries not at all). And as shall be shown presently, Ghana's seeming success, both in debt stock reduction and growth, has much to do with HIPC and MDRI relieves as well as significant growth in exports and their rising world prices.

Ghana is a country example where structural adjustment was touted as very successful, and yet poverty was exacerbated. In March 2001, the government of Ghana decided to access the Heavily Indebted Poor Country (HIPC) Initiative. Since accessing the HIPC initiative Ghana has received high commendation from the International Finance Institutions (IFIs). The question still remains as to whether, after having incorporated a number of reforms, Ghana's debt level is sustainable.

1.2 Statement of the Problem

Various attempts have been made since the debt crises in the 1980s came to global attention to design programmes for debt management in the debtor countries. The most significant has been the HIPC initiative and its attendant MDRI. The results so far in the application of both the HIPC initiative and the MDRI in some debtor countries show that debt levels have appreciably gone down.

[11] In March 2007 the Board of Governors of the Inter-American Development Bank (IaDB) announced the IaDB-07 Initiative, which provides debt relief beyond the HIC Initiative to post-completion-point HIPCs in Latin America and the Caribbean. Thus, there are four multilateral organizations currently involved in the MDRI.

[12] These figures have been sourced from IDA and IMF, *The HIPC Initiative and MDRI – Status of Implementation,* August 2007.

[13] Moss, Todd (2006), *Will Debt Relief Make a Difference? Impact and Expectations of the Multilateral Debt Relief Initiative.* Centre for Global Development, Working Paper No 88, May.

Since the HIPC initiative is both a debt management programme and a pro-poor development arrangement (i.e., aimed at not just reducing debt levels but also ensuring poverty eradication and at the same time allowing for development to meet the MDGs), then ensuring debt sustainability remains a priority.

Debt relief initiatives, coupled with the international community having set the development goals for the new millennium, have renewed attention to the nature and quality of financing for development programmes aimed at achieving the global and national development agendas. There are, however, challenges that pertain to debt sustainability frameworks and practices that remain apparent.

The objective of this project is to identify the contribution of the HIPC and the MDRI programme in the context of assessing the debt sustainability scenarios of developing countries with a view to ascertaining whether the frameworks have been realistic in understanding both the endogenous and exogenous shocks on which these countries operate. And it is against this background that Ghana, whose performance since accessing the HIPC initiative has been acknowledged as very significant, needs to be assessed.

Specifically, the research aims to:

- Give an update of Ghana's HIPC experience and examine the nature and scope of the debt relief realized.
- Describe and critically assess the IMF's debt sustainability analysis of Ghana.
- Ascertain as to whether the DSA calculated has taken into consideration Ghana's strategy for poverty reduction and the MDGs, and make a determination as to whether a balance has been struck between financing for development and poverty reduction that does not impair future generations with a heavy debt burden.

The work is based on the HIPC initiative and the MDRI experience generally in Ghana. It is restricted to documented evidence sourced mainly from the Government of Ghana documents (from the Ministries, Departments and Agencies –MDAs), the IMF and the World Bank, and other researched sources.

The researcher was able to secure interviews from the World Bank and the IMF local offices to augment data from their offices and web-sites. The researcher also had a short interview with the Vice President of the World Bank Group, in charge of Poverty Reduction etc., Dr. Lipsienger, concerning subject matter.[14] Ms. Katherine Bain, the Country Programme Manager of the World Bank in Ghana was also of immense help, as she gave her candid opinion on Ghana, when contacted. Ms. Yvonne Quansah, Principal Economist of the Ministry of Finance and Economic Planning, Ghana, was also contacted.

Having taken a panoramic view of the HIPC initiative and the MDRI, the work reviews Ghana's economy and places it within the context of the two initiatives. Ghana's debt is then subjected to sustainability and vulnerability analyses, using parameters set by the IMF and the Word Bank as well as other economically logical parameters.

[14] Dr. Lipsienger was in Ghana for the UNCTAD XXII Conference held in Accra, 21-24 April 2008. The interview took place 23 rd April 2008.

2.0 Ghana's Experience with HIPC

2.1 Brief Overview of Ghana's Economy

Ghana, at independence, had an appreciably substantial physical and social infrastructure, upon which the nationalist government of the Convention Peoples Party (CPP), under Dr. Kwame Nkrumah, solidly improved. Nkrumah's era was an era of expansionist economic policy, buoyed by $481-million foreign reserves inherited at independence. Monumental public work projects and import-substitution industries created a self-sustaining, stable economy, pivoted mainly on the global primary commodity boom at the time. By 1964 Ghana was exporting about 550, 000 tons of cocoa, (half the world's demand) the main stay of the country's economy. Other raw materials included gold, diamonds, timber, and bauxite.

The end of the commodity boom,[15] beginning in the mid-1960s, the rigid centralized system of economic planning, and the mismanagement of the giant state-owned agricultural and industrial schemes of the Nkrumah era combined to quickly drain the country's foreign exchange reserves, forcing the government to resort to supplier credits to finance many projects. The economy thus started stagnating and declining. Meanwhile, the immediate post-Nkrumah attempts at liberalizing the economy was unable to overcome the inherited restraints on growth, posed by the debt burden, balance-of-payments (BOP) disequilibria, and foreign exchange deficits.

The military interventions of 1972, 1979, and 1981 continued the rigid centralized economic planning system with inflexible controls. Those governments, however, continued to deal with the IMF and the World Bank. The regimes had placed emphasis on self-reliance, debt repudiation and/or rescheduling, and price controls. But these hardly worked, especially as the 1973-74 and 1979 oil price hikes took a heavy toll on Third World non-oil producing economies, including Ghana's.

As macro-economic instability set in,[16] the economy continued to rely on massive injection of foreign capital, especially from the IMF and the World Bank. In April of 1983 the IMF forced the military government of the Provisional National Defence Council (PNDC) to accept and launch what has been described as "perhaps the most stringent and consistent of its day in Africa", an economic recovery programme (ERP).[17] Aimed at halting the downward trend of growth, the programme yielded positive results by recording solid growth between 1987 and 1992 of 5.5%, having totally halted the downward trend by 1987. The widespread direct price controls, over-bloated exchange rates and exchange rate controls etc., were done away with. Liberalization, privatization, getting prices right and limited government, the main principles of the SAP, were solidly adhered to.[18] By this, the moribund sectors of the economy – agriculture, mining, and timber especially – were re-opened. It is noted that the results from this were phenomenal. From a growth rate of negative 4.3% in 1983 the economy grew by 8% in 1984, down to 5.2% in 1986 and shared a steady level of around 5% till 1992. Inflation rate declined from 123% in 1983 to 10% in 1985 rising to 24% in 1986. Central government expenditures and revenue equally increased in real terms and as a share of GDP.[19]

Growth rates, however, stagnated in the 1990s (now exceeding 5%),[20] while, inflation rates began to rise after 1992, reaching an average of 59% in 1995, and declining to 27% in 1997.[21] Macro-instability was experienced in the third quarter of 1999, the economy having been subjected to a combination of shocks (especially sharp decline in cocoa and gold prices, rising oil prices, and short falls in expected external inflows). The shocks may have been exacerbated by government spending, especially in election years of 1992 and 1996.

[15]Cocoa price fell from £320 per ton in 1962 to £90 per ton in 1965, thus derailing Nkrumah's Seven-Year Development Plan (1964-71)

[16]Inflation was more than 100% in 1977, 54% in 1979, budget deficit was about 40% of expenditure in 1979, external debt was about $1billion in 1973. It must be emphasized that this was the case for the whole of sub-Saharan Africa to the extent that average GDP growth for the region by 1979 was negative 1.9%

[17]The Berg Commission Report (1981) had prescribed Structural Adjustment as the only panacea for emancipating distressed economies from stagnation and decline.

[18]By November 1987 the Cedi (the national currency) had been devalued 6,300%.

[19] The foregoing figures have been taken from Abena D. Oduro and George T Kwadzo "Impact of Agricultural Trade and Related Reforms on Domestic Food Security in Ghana," in Charles D. Jebuni and Abena D. Oduro, (eds) *African Imperatives in the New World Trade Order: A Case Study of Ghana*, Accra, AERC/CEPA, 2007, pp 12-13; See also CEPA, *Macroeconomic Review and Outlook*, 2000, Accra.

[20]. The targeted growth for the 1990s was 8-9%

[21]. See Abena Oduro and George T Kwadwo, ***ibid***. p14

It is argued that the high inflationary trends in the early 1990s was a monetary phenomenon, caused mainly by the government printing money to finance what was in fact a non-existent deficit. It is also thought that inflationary expectations ahead of an election year may have played a role, particularly given the government's spending spree ahead of the elections in 1992 and 1996.

No wonder, the nominal exchange rate doubled between 1999 and 2000 as did the rate of inflation. Government ran large budgetary deficits beginning from 1998. Indeed, it was these revealing fiscal and monetary crises that unveiled the major shortcomings of the reform (SAP): the inability to diversify successfully the structure of the economy and the continuing dependence on massive injection of external inflows, the combination of which exacerbated poverty within the economy and created the platform for accession to the HIPC initiative.[22]

2.2 Ghana Accesses HIPC and MDRI

While Leechor (1994)[23] had praised Ghana's adjustment successes and predicted sustainable growth and debt and poverty reduction, Sowah (1994)[24] had predicted opposite outcomes, based on the constancy of fiscal deficits, low output growth, and uncontrollable inflation. Both were writing at the dwindling times of structural adjustment in 1994. It seemed that Sowah's prediction of non-sustainability of earlier gains made came true. It is of no surprise therefore, that, in spite of Leechor's optimism, Ghana had to access the HIPC initiative in 2001.[25]

Delivering a paper on "Eliminating World Poverty: Making Globalisation Work for the Poor", a visiting British Secretary of State for International Development, MS. Clare Short,[26] advised Ghana to access the HIPC Initiative in order to benefit from debt relief. Basing her arguments on certain indicators of the Ghanaian economy as of 2000, and extolling the virtues of accessing the HIPC Initiative, Ms. Short virtually told the Ghanaian government that it had no option nor time, and that accessing the HIPC Initiative was the only way out. Meanwhile, a purported independent survey, conducted by the Debt Relief International, which Ms. Short referred to in her paper, had concluded that Ghana was likely to save between $773 million and $875 million by the year 2003, if she accessed the HIPC Initiative.

The government, hesitant though it was, (since public opinion at the time was clearly against accessing HIPC), made the announcement about accessing the HIPC Initiative in the Budget Statement in March.[27]

One of the basic issues that must have aided the choice to access the HIPC Initiative must have been the very fact that the previous government had in 1999 prepared an I-PRSP.

Table 2.1 Ghana: HIPC Receipts and Expenditure, billion Cedis

HIPC	2002	2003	2004	2005	2006
Multilateral	499.2	815.4	1,052.5	961.5	751.1
Bilateral	0	209.4	1,064.8	1,193.5	927.0
Total	499.2	1,024.8	2,117.3	2,155.0	1,678.1
Expenditure	175.1	866.3	1,869.6	1,946.6	1,791.6

Source: Ministry of Finance and Economic Planning (MoFEP), Ghana

[22] The foregoing marked the beginning of the exacerbation of Ghana's debt situation. At the inception of the SAP in Ghana, Ghana's total debt was $600million; by 2000 it stood at $6, 700million.

[23] Leechor, C (1994), "Ghana: Frontrunner in Adjustment", in Hussein, I. and Faruque, R (eds*.), Adjustment in Africa: Lessons from Country Case Studies,* World Bank, Washington D.C.

[24] Sowah, Nii K., (1994) "Fiscal Deficits, Output Growth and Inflation Targets in Ghana", *World Development, Vol 22 No. 8*

[25] By the close of 1998 all indications were that Ghana had to access the Enhanced HIPC Initiative. The then government prepared an I-PRSP in 1999 but shelved accession in view of an impending election (2000). The accession to the HIPC II in March 2001 was therefore a matter of course. See the preamble to the G-PRSP 2001

[26] Ms Clare Short was on an official visit to Ghana and gave a Public Lecture at the British Council Hall, Accra. Her lecture generated a public debate, especially as the Japanese Ambassador to Ghana warned Ghana about the implications of accessing HIPC.

[27] Government was very reluctant. It had just been ushered into office, inexperienced and very unprepared in engaging the international system head on that way. From the Budget Statement, it was clear that new President took a personal responsibility. That portion read "The President has directed- - -" See Ghana Budget Statement, March 2001.

Because Ghana had been on IDA-programmes for a long period, she reached the decision point very early (February 2002), and subsequently reached the Completion Point in July 2004. It must be emphasised that the IMF-World Bank commitment to Ghana's PRSP has been phenomenal.[28] This is borne by Table 2.1 below.

As a result Ghana's debt has reduced considerably and has been projected to continue this downward trend, if the macro-economic stability and the fiscal and monetary prudence of the government are maintained.[29] Besides, available data indicates that continued projected inflows can prop up the economy to achieve growth and debt reduction well into the future. See table below.

As already indicated, the MDRI was proposed in 2005 to further free up additional resources for post-completion point HIPC countries. Since Ghana had reached the completion point by 2004, she was among the first group of countries to benefit from this dispensation. The AfDB joined the IMF and IDA in approving, in April 2006, total debt relief under MDRI of $8.5 billion over the next 50 years, from 2006 to 2054. Ghana has so far also received a total of $4,429 million debt relief from the IDA of which $1,446 million represents HIPC relief and the remaining, $2,983 million, comes from MDRI relief. See Table 2.2 below.

Table 2.2 Estimated Debt Relief Provided Under HIPC and MDRI, USD millions, as of July 2006

COUNTRY	Total Debt Relief by IDA ($million)	HIPC Relief ($million)	Estimated MDRI Relief ($ million)
Ghana	4,429	1,446	2,981

Source: IMF

2.3 Evaluation of HIPC

Propped by the HIPC initiative and the MDRI, Ghana's economy has performed well under the New Patriotic Party (NPP) administration. Prudence in economic management under the HIPC initiative demands has earned major debt relief and large inflows of donor resources. This situation has been supported positively by high cocoa and gold prices in the last few years. The two commodities have been the key to the steady improvements in real GDP growth, which in 2004 exceeded 5% for the first time in many years and reached 6.2% in 2006.[30] Marked improvement is also seen in fiscal developments. Reduction in domestic debt-to-GDP ratio down to 8.7% in 2006 from a previous 10.8%, an overall budget deficit of only about 2.1% of GDP (down from 4.87%), and a 2.05% of GDP surplus in the primary balance, speak volumes about the level of steady progress.[31]

Monetary and fiscal developments equally look good. Monetary policy is primarily focused on achieving single digit inflation and a stable exchange rate. The challenge, however, is in continued high crude oil prices, water and energy crises as well as worker demands for higher wages and salaries.[32] The year on year inflation has declined from 15.5% to 10.9%. This has allowed the Central Bank to relax monetary policy and drive down interest rates in the money market. High commodity prices and strong transfer inflows gave a good outlook of the external sector, however the narrowness of the export base and Ghana's heavy reliance on donor inflows and remittances create a more vulnerable situation. A 400% increase in overall balance-of-payment surplus (from $84.3million to $415.1 million, has been attributed to positive export performance and growth in remittances, donor resources, and debt relief. A remarkable rise in net transfers was observed systematically since the NPP administration took over, however there has also been a growing current account deficit.

[28] For instance, the Bank and the Fund teams closely coordinate their policy advice to the Ghana government. The government often holds Consultative Group Meetings with the Bank and Fund Boards to discuss Country Assistance Strategy and the GPRS II. A chronology of such cooperation is set out as Appendix to the Staff Report (Ghana) for the 2007 Article IV Consultation, Washington DC, IMF, May 2007, pp 48-53.

[29] See Fig… below

[30]. See ISSER, *The State of the Ghanaian Economy in 2006*, Accra, ISSER, 2007 p3. The real GDP growth for 2004 was 5.8%

[31] *ibid.* p17

[32] See Fig.. below.

The greatest threat to the external sector of Ghana's economy has been the volatility in world crude oil prices that not only cause rising import bills, but also jolts in all aspects of the economy.

3.0 Ghana: Debt Sustainability Analysis

3.1 Assumptions

The IMFs debt sustainability framework is based on three parameters: the country's institutional assessment, its stock of external debt, and its ability to repay. The ability to repay is based on government revenues. Though, since external debt is denominated in foreign currency, the relevant earnings are those, to a large extent, from exports and, to a lesser extent, customs. This is why the need for relief is a decision made based on two criteria: the ratios of debt-exports and debt-government revenues.

3.2 IMF Assessment of Ghana's Debt Sustainability

The current of debt sustainability analysis (DSA) framework was introduced in 2005 by the World Bank and the IMF. It is based on the following pillars:

- A standardised forward-looking analysis of debt-service dynamics under a base-line scenario;
- A debt-sustainability assessment based on indicative country debt burden thresholds that depend on the quality of policies and institutions in the country;
- Recommendations on the borrowing and lending strategies to limit the risk of debt distress, while maximizing the resource envelope to achieve the MDGs.

Four basic scenarios have been worked out in analyzing Ghana's debt sustainability. These are a Baseline Scenario, Alternative A scenario, Alternative B and Alternative C scenarios. The Baseline scenario has the following assumptions:

- Macro-economic stability (prudence in fiscal and monetary management, single digit inflation) and continued structural reforms
- Ghana's high credit rating of B+ and conservatism on interest rate spreads; and
- Prudent borrowing and efficient management of borrowed funds.

The baseline is based on the following expectations: real GDP growth of about 7% until 2011 and averaging 5.8% between 2012 and 2026; declining inflation rate down to 2.5 percent by 2012; an annual growth rate of about 13.4% of exports of goods and services during 2006-2011, with non-traditional exports growing at 16 percent between 2006 and 2026; remittances expected to be around 15% of GDP, while FDI is expected to average only 4% of GDP and official external grants as share of GDP projected to decline. Official concessional loans are projected to average 4% and reserve coverage of imports would exceed 5 months of goods and services in the outer years. The tax-to-GDP ratio would rise to 20.5 percent by 2012. The IMF's assumptions on interest rates on international markets were based on the fact that the present favourable market conditions may not persist over the projection period. An annual interest rate of 9.5% was used. The borrowing assumptions are contingent upon gross concessional flows through 2012 not exceeding 7 percent of annual GDP, while non-concessional borrowing is expected to be in the range of $200 – 350 million a year amounting to 1 – 17 % of annual GDP between 2007 and 2012 and one percent of annual GDP afterwards.

Alternative A scenario assumes baseline borrowing with lower GDP growth and lower exports. Alternative B scenario presupposes an increase (probably a doubling) of non-concessional borrowing with a baseline growth target, while Alternative C scenario assumes higher non-concessional borrowing as of Scenario B and a lower growth from Scenario A.

Table 3.1 Scenario A: Debt Sustainability Indicators (Baseline Borrowing/Low GDP and Export Growth), per cent

	2006	2015	2026	Thresholds
NPV of Debt-to-GDP	18	27	36	50
NPV of Debt-to-exports	46	93	182	200
Debt service-to-exports	12	10	19	25

Source: IMF

Table 3.2 Scenario B: Debt Sustainability Indicators (High borrowing/ Baseline growth)

	2006	*2015*	*2026*	*Thresholds*
NPV of Debt-to-GDP	18	29	35	50
NPV of Debt-to Exports	46	94	151	200
Debt service-to-exports	12	12	18	25

Source: IMF

Table 3.3 Scenario C: Debt Sustainability Indicators (High borrowing/ Low Growth scenario)

	2006	*2015*	*2026*	*Thresholds*
NPV of Debt-to-GDP	18	30	39	50
NPV of Debt-to Exports	46	101	199	200
Debt service-to-exports	12	14	24	25

Source: IMF

Using the scenarios described above, the IMF concludes that 'Ghana's risk of external debt distress is in the lower range of the moderate category'.[33]

Table 3.4 Summary of Debt Sustainability Analysis

External Public and Publicly Guaranteed Debt Burden Indicators (in percent)

Scenario	2006	Baseline	A	B	C	Thresholds
NPV of debt-to-GDP	18	28	36	35	39	50
NPV of debt-to-exports	46	121	182	151	199	200
Debt service-to-exports	12	13	19	18	24	25
Plus Remittances?						
NPV of debt-to-exports	34	80	...	...	...	...
Debt service-to-exports	9	9	...	...	...	...

Clearly, under the baseline scenario, all of Ghana's external debt-burden indicators remain below these thresholds. Alternative scenarios A and B would still leave Ghana within the moderate bracket, but the risk of debt distress would be higher than the base scenario. However, scenario C, which assumes higher non-concessional borrowing from scenario B and lower growth as in scenario A would leave Ghana approaching high risk of debt distress, as all stress tests and historical scenarios would exceed the thresholds.

Asked to comment on these findings, both Mr Leipzinger, and Ms. Katherine Bain stated that Ghana's debt sustainability was indeed moderate, albeit close to the low risk category.

[33] IMF (2007), *Ghana: Staff Report for 2007 Article IV Consultation*, Washington DC, IMF, p32.

Ms. Bain was emphatic that even under country-specific alternative scenarios, the baseline debt trajectory is still below the relevant indicative thresholds. Both were quick to add though, that the country-specific trends show that sustainability could deteriorate in the case of slower than projected growth. It would be worse if this situation is compounded by increased borrowing on non-concessional terms. Liepzinger recommended that Ghana should move towards IBRD loans rather than access international markets, and, if anything, the latter option should be gradual. Mrs. Yvonne Quansah, on her part, was optimistic about Ghana's debt position. With prudent and judicious use of funds and sound macro-economic policies, currently being pursued by the government, she sees no reason why Ghana's vulnerability to exogenous shocks cannot be contained.

Researchers at Ghana's Institute of Statistical, Social, and Economic Research (ISSER) have also concluded that 'Ghana's debt is currently sustainable.'[34] Before arriving at such a conclusion though, ISSER took a look at the HIPC initiative, acknowledging that the objective is to help countries achieve debt sustainability and become free of the cycle of rescheduling. According to ISSER, there has been a remarkable decrease in the debt-service ratio in Ghana, partly due to the increase in Ghana's GDP, but mainly also due to the substantial debt reduction the HIPC initiative has generated.

However, ISSER's findings also conclude that debt servicing now stands at 27% of domestic revenue.[35] If such a trend persists it may be difficult to run the economy effectively only on 73% of domestic revenue. The more plausible fact is that debt servicing as a percentage of GDP has dropped from about 14% in 2000 to a mere 6% in 2006.

The Country Policy and Institutional Assessment (CPIA) is a measure of a country's economic, institutional and governance framework that was primarily developed to allocate IDA finances.[36] The CPIA is perceived to fully assess a given country's vulnerability to debt distress and classifying a country as per the debt and debt service benchmarks, by measurement of the net present value (NPV)-that is the discounted value of future debt repayment) through a consideration of its debt-to-exports ratio and its debt-to-GDP ratio and its debt service-to-exports ratio. A country is regarded as severely indebted if the present value of total debt service to gross national income (GNP) exceeds 80 percent or if the present value of total debt service to exports exceeds 220 percent. This would imply that a big chunk of a country's revenues earned from exports is actually lost to debt servicing than being ploughed into the more deserving programmes of the economy to generate investment and growth, for poverty reduction and debt sustainability. The World Bank has categorized Ghana as a strong performer.

3.3 Alternative Debt Sustainability Indicators

Debt sustainability analysis must always be subjected to stress tests, and within certain thresholds, which come in the form of macro-economic shocks, policy dependency, and reform slow-downs.

Using the base scenario assumptions, there is every indication that the GOG can reach its growth and poverty reduction goals (and the MDGs), but given the stress tests, this would mean sustained efforts and additional financial resources to fund them. It is here that some observers show concern.

They argue that in a debt management situation such additional funds may be absorbed either by a) an increase in reserve accumulation, b) an increase in capital outflows, and c) an increase in the current account deficit. For most observers[37] alternative c) is preferable for developing countries like Ghana, as this is an expansionary policy option that would maintain a lower policy interest rate.

A possible widening trade deficit may be financed with foreign exchange reserves. In that sense Alternative Scenarios A and B would show moderate sustainability but a higher risk of debt distress than the Baseline Scenario.

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[34] ISSER, (2007) *The State of the Ghanaian Economy in 2006* Accra, ISSER, p50

[35] It is true that the trend has improved tremendously. In 2000 over 80% of domestic revenue went into debt servicing. But the 27% which ISSER thinks is appreciably good is still beyond the threshold of sustainability prescribed by the HIPC Initiative. (The threshold was put at between 20 and 25%)

[36] EURODAD, Still the Point: Unpacking the new World Bank/IMF debt sustainability framework, Position paper, September, 2005, p.5

[37] See for instance, Chowdhury, A and McKinley, T (2006), *Gearing Macro-economic Policies to Manage Large Inflows of ODA*,New York: UNDP, pp17-24

Scenarios C cannot be an option or that would definitely exacerbate the NPV debt–to–exports ratio and the debt service–to–exports ratio would approach thresholds beyond sustainability.

The DSA requires projections of external and total public sector indicators. One other test of sustainability therefore, is to subject Ghana's indicators to External Vulnerability Analysis (EVA). It is clear from the table below that Ghana's public sector debt has reduced from, 118.8% of GDP in 2003 to 42.4%, thanks may be to the effective accession to the HIPC and the gains from the MDRI. However, the growth of exports is tenuous and primarily based on two commodities, cocoa and gold.

Table 3.5 Ghana's Export Performance, USD millions

Year	Total Exports	% Cocoa	% Gold
2003	2471	33.1	33.6
2004	2785	38.4	30.2
2005	2803	32.4	33.7
2006	3680	32.2	34.7
2007	3980	28.3	39.3

Further, official reserves have shown marked improvement (increasing from $1427 million in 2003 to $2325 million in 2006); no doubt, though it is no longer under an IMF programme, a result of being under a PRGF programme since 1995.

The Government of Ghana is keeping track of its fiscal vulnerability. [38] Its vulnerability is declining due in part to the Multi-Donor Budgetary Support (MDBS) and in part to the substantial increase in public revenues and expenditures. Total government receipts have increased in real terms by 159% within seven years rising from 18% of GDP in 1999 to 24.1% in 2006.[39] This increase has been achieved mainly from domestic revenue. Revenue-enhancing measures as well as improved tax administration, coupled with greater collection of internally generated funds and higher levels of remitted profits account for this achievement. Such increases in domestic revenue have enabled government to reduce reliance on aid receipts. In the past the government was entirely dependent on aid grants and loans to cover the entirety of its discretionary spending and a substantial part of non-discretionary spending.

Table 3.6 Ghana Fiscal Vulnerability

(in billions of Cedis, 2000=100)	1999	2000	2001	2002	2003	2004	2005
Domestic Revenues plus HIPC Relief	4,254.2	4,810.7	5,195.0	6,093.9	7,532.2	9,209.5	9,623.2
GOG Expenditure plus debt repayment	5,879.6	8,085.8	7,028.3	8,067.7	9,030.7	10,579.3	10,265.6
o/w non-discretionary	4,700.7	6,609.6	6,260.6	7,125.5	7,603.0	7,302.3	8,122.0
Government funding financed by non-revenue sources (as a % of discretionary spending)	138%	222%	239%	209%	105%	42%	30%
Vulnerability deficit	-1,625.5	-3,275.1	-1,833.3	-1,973.8	-1,499.5	-1,369.9	-642.4
Vulnerability deficit as a % of GDP	**-6.31%**	**-12.06%**	**-6.41%**	**-6.31%**	**-4.38%**	**-3.74%**	**-1.66%**

Source: CDD, Ghana

Fiscal vulnerability is a vital measure in debt sustainability assessment, in that in the event of shortfalls in donor budget support, discretionary expenditures within the core budget programmes would have to be cut or financed by borrowing from the domestic financial system. This would throw off balance programmes for poverty reduction as well as swell the domestic debt.

[38] Fiscal vulnerability is measured in terms of potential severity of budget cuts arising from the loss of budget support.

[39] CDD/ODI (2006), *Evaluation of Outputs, Outcomes & Impacts and Recommendations on Future Design & Management of Ghana MDBS*, Accra & London, CDD/ODI, p68

The decreasing fiscal vulnerability of the Government of Ghana, if maintained, would ensure health of the economy and therefore success of the Ghana's Poverty Reduction Strategy.

Lastly, the ratio of payments on domestic debt as a proportion of domestic revenues captures the budget sustainability of the debt burden. Given that donor grants are not significant to cover the fiscal shortfall, the tendency towards domestic financing is strong. The proportion of domestically generated revenues going towards payments on the domestic debt stock is critical.

Table 3.7 Consideration of Budget Sustainability of Domestic Debt, Cedis billions

Year	New Loans	Payments on Domestic Debt	Total Revenues, less grants	Domestic debt-Budget Ratio, %
2005	4437.0	996.2	23156	4.3
2006	5383.4	1167.7	25569	4.5
2007	6018.6	2740.0	31143	8.8

Table 3.8 reveals that the ratio of domestic debt to total revenues has nearly doubled between 2006 and 2007. This is no doubt a result of having taken out new loans, but also a result of total revenues not sufficiently increasing to accommodate the service payments

3.4 Concerns Regarding Ghana's Debt Sustainability

There is a need to think more broadly about what debt sustainability entails, given the current development framework. Treating external and domestic debt separately doesn't give adequate attention to the fiscal space that is needed to finance the MDGs. However, the need to access international markets is based on Ghana's desire to meet its development targets. The GPRS II estimates that a resource envelope of US$8.6 billion is required to do so; indicating an overall funding gap of $1.79 billion. Donor commitments to Ghana's second Poverty Reduction Strategy (GPRS II) are not anticipated to increase substantially.

Table 3.8 Donor Commitments to Ghana

Year	Donor Commitments, USD millions
2007	1292.7
2008	1382.9
2009	1434.7
2010	1255.0

Source: AFRODAD (2007)

Historically, not unlike many other African countries, grants have not been able to bridge the gap between government revenues and recurrent and capital expenditures, which has actually widened since 2003 despite debt relief.

Table 3.9 Ghana Fiscal Balance

Year	Total Revenue	Total Expenditures	Fiscal Deficit	Grants
2003	13743	19035	5292	3119
2004	18994	26584	7590	5080
2005	23156	29895	6739	5100
2006	25569	40051	14482	6195
2007	31143	47126	15983	7079

Source: IMF (2007)

Secondly, there is perhaps an over-emphasis on projected values (government revenues, export growth, etc.). A country's past and current performance is the best indication of how it will fare, given the projected expenditures it must undertake. For example, the baseline projects:

- Seven (7) per cent GDP growth until 2011, but Ghana has never recorded 7% growth going as far back as 1996.
- Annual growth rate of about 13.4% of exports of goods and services during 2006-2011, with non-traditional exports growing at 16 percent between 2006 and 2026. However, Ghana's export performance is rocky. Exports grew by 12.7% between 2003-04; 0.6% between 2004-05; 31.2% between 2005-06; 8.1% between 2006-07.

The fiscal indicators below show that an external shock, albeit positive, must take place to in order for Ghana to keep pace with its GPRS II and new loans.

Table 3.10 Historical Fiscal Indicators for Ghana

Year	Tax Revenue as % GDP	Total Domestic Revenue as % GDP	GDP growth
2003	20.2	20.8	5.2
2004	21.7	23.8	5.6
2005	20.6	23.8	5.9
2006	19.6	21.6	6.2
2007	20.0	22.2	6.3

Various Sources: AFRODAD (2008), Ghana Ministry of Finance and Economic Planning[40]

Thirdly, IMF staff maintains that the projected net present value (NPV) of external debt at end- 2006 of about 12 percent of GDP is about one-third the level of end-2002 (Figure 1), and the NPV of total government debt of 34.4% of GDP at end-2006 compares with 87.8% in 2002. Thus, the relief under the HIPC at the completion point, combined with the relief under the MDRI, created a significant space between the existing position and most established threshold points for prudent debt management. The conclusion being that this has provided Ghana with some cushioning against external shocks. The NPV of its external debt has indeed declined, but this is due to the significant drop in inflation rates (15.2% in 2002 and 8.3% in 2006) and not the stock of external debt, which was 2,345 billion cedis in 2002 and 3,473.1 in 2006.

Further, Ghana being a natural resource-intensive economy, external shocks would most likely result from changes in commodity prices, lowering the expected amount of foreign capital reserves. 41.6% of its export earnings in 2005 came from cocoa.[41] Commodity price indices tracked by UNCTAD reveal that cocoa prices have become more variable in recent years, with the standard deviation between 1960 and 2004 being 9%; 49% between 1980 and 2004; and 66% between 1995 and 2004.[42]

A fall in the price of cocoa would indeed inhibit Ghana from making its currently exorbitant external debt service payments ($4,537.4 billion cedis in 2006), while having contracted new loans amounting to 5,383.4 billion cedis in the same year.

[40] http://www.mofep.gov.gh/news170608.htm; accessed on 15 July 2008
[41] African Development Indicators, 2007, World Bank.
[42] Calculated from UNCTAD database of commodity prices, www.unctad.org

4.0 Conclusion

The accumulation of large debts naturally generates a debt overhang that creates a permanent climate of financial fragility for indebted countries. For Africa this is crucial as debt servicing obligations crowd out resources for social services and therefore exacerbate poverty situations. The enhanced HIPC Initiative, which Ghana accessed in March 2001, has been of immense help in creating conditions for macro-economic stability and growth. Prudence in economic management, especially fiscal and monetary discipline, has contributed to Ghana's stability. Reaching completion point in 2004, Ghana's public sector debt as percentage of GDP declined, from an initial volume of 118.8% in 2003 to 42.4% in 2007.

The IMF and the World Bank have rated Ghana's debt sustainability as moderate albeit close to the low risk category. Though Ghana's strategy of accelerating growth (large infrastructural projects to raise growth potential) is laudable, there is a tension between these development expenditures, though long-run returns are expected by way of productivity, and non-concessional borrowing. Moreover, external vulnerability in the form of shocks (oil price hikes, fall in commodity prices, and water crises as well as wage rise demands), may force budget expenditures to be funded from domestic borrowing.

The DSA Framework

There are some questionable assumptions and glaring omissions with the currently used DSA framework, which require due consideration.

- The ability of Ghana to earn foreign currency from its exports is a valid component of debt sustainability but should not be its basis. The concept of fiscal sustainability draws on the idea that public debt cannot keep on growing relative to national income because this would require governments to constantly increase taxes and reduce spending on goods and services.[43] But this should also be broadened to take into consideration the extent to which current and development expenditures compromise the country's future fiscal position.
- The conventional approach treats fiscal and external sustainability independently and does not provide a systematic examination of the links between the two. The analysis of fiscal sustainability focuses on the ability of the government to generate an adequate level of primary budget surplus in order to stabilize its debt ratio, but ignores that servicing part of that debt requires availability of foreign currency. External sustainability emphasizes the need for the economy as a whole to generate an adequate amount of foreign exchange surplus in order to service and stabilize its external debt, but pays no attention to whether public and private debtors each are able to generate the required saving surpluses.
- There are also concerns about the endogeneity of IMF variables in its DSA. For example, the focus on government revenues through taxation is complex. In a developing country, a projected increase in the former is almost entirely based on an increase in not only economic growth but also a change in the income distribution. This is the only way that any government would be able to extract more from taxes. For countries that are resource extractive, this would imply that, to some degree, the increase in incomes would come from the success of exports. Also, there is the indication, that if tax revenues rely, in part, on economic growth, then domestic debt sustainability relies in part on external factors (exports revenue, commodity diversification, international trade regimes, etc.).
- There are links between external debt sustainability and domestic debt sustainability, which require closer inspection of social welfare policy. There is a social dimension that is not addressed by the IMF.

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[43] Akyuz, Yilmaz (2007). Debt Sustainability in Emerging Markets: A Critical Appraisal, DESA Working Paper No. 61, November 2007.

> ***From a social point of view, debt levels are not sustainable if scarce resources of the state are spent on debt service instead of fighting hunger, malnutrition, lack of education and poverty. Common sense requires that the interests of the population simply be considered of superior importance with respect to debtor claims on the repayment of debts. It is simply not good enough to use "neutrally" universal macroeconomic and financial variables to determine the sustainability of debts. Even "favourable" macroeconomic variables – such as high growth rates or rising export revenue – do not say anything about how much is actually lacking in terms of materially securing daily survival. Therefore, social criteria are at least equally important in the determination of sustainability as are economic variables.[44]***

- Finally, there is a political dimension that can only be addressed by non-state actors. Countries under IMF programmes are rarely deemed unsustainable or else the IMF would have to explain why it is a creditor to the country and signalling to other donors to do the same. There is an obvious conflict of interest.

> ***Neo-liberal assumptions are always based on models of economic policies geared towards achieving a capacity to repay instead of achieving real sustainable development. If the focus of interest is on the repayment of debts, then it will mainly be in the interest of creditors – whether they are official creditors or private banks.[45]***

Moreover, deciding how much will go towards development expenditures and to which targets are, themselves, the outcomes of a political process. Thus, the determination of debt sustainability cannot be decided externally, but must be the outcome of advocacy, negotiations and compromise, which can only take place internally.

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