

Managing Ghana's Domestic Debt

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Ghana certainly faces a debt problem. Central Government gross domestic bonded debt alone stands at over 25 percent of national output and 123 percent of total budget revenue. The domestic debt attracts interest payments that far exceed government expenditures for development. The domestic debt has grown very fast over the last six year, with the increasing deficit that has become structural. In 1990 the debt was less than 3 percent of national output; but, made a leap to 25 percent in 1996 and has hovered around that level since. If the domestic debt as at the end of 2000 was to be shared equally among Ghanaians (including babies), each Ghanaian would be carrying a debt burden of about 420,000 cedis. This certainly is an enormous burden!

Evolution of the Debt

Generally, debt is incurred to:

- Finance the Government deficit;
- Accumulate foreign and domestic assets; and
- Repay other previous debts.

Since independence, Ghana has always had problem with central government finances. Government has never been able to marshal enough revenue to take care of its expenditures. This creates deficits, which have to be financed either by borrowing (from domestic or external sources) or by resorting to the "printing of money". The latter form of financing the deficit can be inflationary while the former creates debt.

In the 1970s, the deficit was mostly money financed leading to strong inflationary pressures. This mode of financing was forced on the economy by the financial environment of the time. The financial system, particularly the money market, was underdeveloped and Treasury bill was not a popular financial instrument; thus the Government could not borrow from domestic sources to support the budget. On the other hand, foreign borrowing was also limited, as the international financial community had blacklisted the country following repudiation of some external debts by the Government of the National Redemption Council led by General Acheampong. Hence, the only avenue open for financing the deficit was through the "printing press". This caused inflation to spiral upwards, hitting 123 percent in 1983.

Between 1983 and 1989 the hallmark of Ghana's commitment to economic reform, under the Structural Adjustment Program, was fiscal prudence. Aided by balance of payments and budgetary support from external sources, Ghana was able to maintain broad budget surpluses between 1986 and 1990. Of course, the external borrowing created a pile up of external debt for the country. However, most of the external borrowing was on concessional basis with long moratoriums and with no short-run threat to the macroeconomy.

The domestic debt is a problem of the 1990s. Gross domestic bonded debt rose sharply from 3 percent of GDP in 1990 to about 25 percent of GDP at the close of the millennium. See Appendix 1. The evolution of the domestic debt was through fiscal excesses beginning from 1990. Unbudgeted outlays for hosting of the Non-Aligned Movement's Ministerial Conference and the Peacekeeping operations in Liberia (ECOMOG) in 1990, and later expenditures on District level elections proved to be too much strain on the fragile economy and the country has not recovered since. In the case of the district level elections, as in all other political expenditures, there were budgeted costs related to the process and unbudgeted costs to influence the process. The fiscal pressures of these unplanned expenditures were exacerbated by the fact that the availability of program aid was very limited in the 1990s and disbursement of project aid had slowed down considerably — not unrelated to the policy failures.

Comparing changes in the debt from year to year with the fiscal deficits of each year shows that the debt was driven mostly by the deficit. In 1996 the budget plunged into a deficit, and has only deepened over the years. From about 3 percent of GDP in 1996, the deficit rose to about 17 percent at the close of 2000. Table 1 compares the changes in the domestic debt (less revaluation stocks) with the deficit for each year. It is clear that since 1997, borrowing from domestic sources was not even enough to finance the deficit. Thus for the last half of the 1990s the country had to borrow externally and/or print money to finance the deficit.

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Change in Domestic Debt	-5.8	74.7	350.1	58.1	200.9	594.4	872.0	994.7	1301.8	855.5
Change in Treasury Bills	-8.5	20.3	18.3	32.7	86.4	450.0	677.9	751.8	1734.3	872.2
Deficit (-) / Surplus (+)	39.1	-	-97.6	111.7	70.3	-335.4	-1174.2	-1048.7	-1339.7	4531.0
PSBR	-51.8	144.2	45.6	-26.7	-27.7	531.1	728.0	672.6	1117.5	2397.2
Interest Payments	10.6	24.9	94.3	166.4	232.9	434.5	644.9	861.4	872.0	1446.2
Real Interest Rate (%)	18.9	6.1	3.3	-4.7	-30.3	10.1	21.7	11.1	17.7	-2.5

Nature of the Debt

The more tractable debt is that which is bonded. That is, debt raised by central government through the issue of Treasury bills. It has been quite difficult to estimate the actual size of the total domestic debt. The first issue relates to coverage. Total public debt must be defined to include the debt of (i) the central government; (ii) the municipal and local governments; and (iii) state owned enterprises and subvented organizations. Generally, the discussion gets focused on central government debt to the neglect of the other forms of public sector debt. However, local government debt may have come about because of delays in the release of the District Assemblies Common Fund by central government. In the case of state-owned enterprises such as the Tema Oil Refinery (TOR) delays by central government in instituting proper pricing policies

led to huge implicit subsidies on fuel resulting in a pile up of debt totaling trillions of cedis. Thus, the true size of the domestic public debt must include the debts of all these organizations.

The coverage issue aside, the actual size of the debt is made fluid by the existence of payment arrears in the system. For some years now, government has been postponing honoring its obligations to some contractors, particularly those in the road sector. This has created a stock of payment arrears, which is officially neglected in the computation of the gross domestic debt.

Further, included in the classification of the debt is the revaluation stocks issued by government to the central bank in respect of losses incurred in the revaluation of net foreign assets owing to the depreciation of the currency. For a long time, this was on the books of the central bank, rendering its net worth negative, and creating operational problems for the Bank. In 1996, a decision was made to transfer the revaluation losses to Government in exchange for interest bearing stocks: this has since been part of the debt. Although since 1996 there has been further accumulation of losses, no new transfers have been made to the central government accounts. Indeed, revaluation losses currently on the balance sheet of Bank of Ghana are much more than what has so far been transferred to central government's account. Since this is not an expenditure-related debt, it may be necessary to exclude the revaluation stocks from the debt in order to evaluate properly the budget-related debt.

Figure 1: Maturity Structure of the Domestic Bonded Debt in Ghana (in billion cedis)

Decomposition of the Debt

By the year 2000, the gross domestic bonded debt of central government and the central bank has reached almost 7 trillion cedis. See Figure 1. The limited availability of different forms of financial instruments on the money market places a limitation on the forms of debt held. Much of the debt is of short-term nature. About 90 percent of the debt is held in the form of 91-day and 180-day Treasury bills. Long-term bonds are only held by the central bank. In 1993 long-term stocks issued amounted to 291 billion cedis and this was increased to 590.7 billion cedis in 1996.

Consequence of the Debt

The debt has both fiscal and monetary consequences. The gross domestic bonded debt (excluding revaluation stocks) is larger than the total government revenue. Interest payment on the debt is about 15 percent of total expenditure, more than the development expenditure, and greater than the total of the expenditure on health and education combined. Thus, the size and rate of growth of the debt weakens the ability of the fiscal to meet social and developmental commitments.

More frighteningly, the size and high rate of growth of the debt can lead to state of bankruptcy in which the Government fails to honour its debt obligations. This situation will arise when the fiscal cannot meet the *solvency criterion*. The fiscal is said to be solvent if the present value of the future streams of the country's income is larger than the size of the debt. It is important to do this computation and ensure that the fiscal never becomes insolvent.

The debt also creates monetary problems. Because government needs to borrow more to take care of the debt due and also to close the fiscal gap, interest rates are kept high and attractive. A profile of interest rates reveals real rates ranging between 10 and 21.7 percent between 1996 and 1999. The high interest rates worsen the debt burden and cause government to borrow more to service it. Thus the Government becomes a "debt junkie".

The fiscal and the monetary consequences of the debt lead to poor economic growth. Investment by the private sector is slowed because of the high rates of interest and also because the public sector "crowds out" the private sector in the credit market.

Management of the Debt

Clearly, the first recommendation for containing the debt will be to aim for surpluses on the fiscal. Participants at the first National Economic Forum agreed to this in 1997; but the Government of the National Democratic Congress did not commit itself to its implementation. It is a fact that so many national development projects and social programmes are waiting to be implemented. Thus, reducing the fiscal expenditure may be problematic and may be politically costly. Elimination of waste and switching of expenditure into more productive areas may be more beneficial. The Government may also have to find ways of generating more revenue to achieve the budgetary surplus. The inflationary consequences and loss of macroeconomic policy consistency and stability that followed the introduction of the VAT in 1995, however, are a reminder that generating non-inflationary revenue may be no less problematic than restraining expenditure growth.

Some amount of surprise inflation in the system can also help to reduce the debt. Basically, the government as the debtor will gain for any rise in the general price level. But, quite apart from the inflation tax, the rise in the general price level creates seigniorage revenue for Government that can be used to pay back the debt. But, this can backfire. It has been established in the economic literature that as inflation increases seigniorage revenue can only increase up to a point, after which it then fall. However, inflation once initiated may be difficult to control.

A third method of containing the deficit will be to divest some of the national assets. For some time now some state owned enterprises have been on the divestiture list and it is about time to push them for sale. Others that have been divested for which payments have not been made should be settled as quickly as possible. It is important that the divestiture be properly indexed to either foreign exchange or inflation so that value is not lost in case of long delays in payment.

Finally, it may be necessary for government to transform some of the debt from short-term to long-term. At the same time, if the official inflation numbers are to be believed, the rates of interest on the Treasury bills are too high, even in real terms. It is important to note that banking regulation already makes it mandatory for the banks to hold secondary reserves in the form of Treasury bills. Thus, the banks do not need too much "convincing" to invest in Treasury bills. With the non-bank public, the low rates on saving deposits makes the rates on the Treasury bills "too attractive". In sum, the Treasury bill rates can come down by some percentage points without hurting demand, while giving tremendous boost to debt reduction.

Conclusion

The domestic debt has become a problem not only because of its size but also the rate at which it is growing. The exact size of the debt is not known because of the presence of some payment arrears in the system and because of present limitation of coverage. A large portion of the debt is held in short term bonds with high real rates, which create a vicious circle for the debt burden. The fiscal and monetary consequences of the debt are enormous with a threatening possibility of insolvency occurring in the near future. It is important to move the fiscal from the chronic deficit position into surpluses, to reduce the growing threat from the debt. The Government must divest some national assets and use the proceeds to reduce the debt. In the meantime, there must be an urgent national audit program to ascertain the full size of the debt from central government, municipal and local governments, and state-owned enterprises including subvented organizations. It is also important to compute the exact size of the payment arrears in the system to get a better picture of the debt situation.

Appendix 1: Domestic Debt (in billion cedis)								
	1990	1991	1992	1993	1994	1995	1996	1997
<i>Government Domestic Bonded Debt</i>	54.0	48.2	122.9	473.0	531.1	732.0	2628.8	3500.0
<i>of which:</i>								
<i>Government Stocks</i>	25.5	28.2	46.8	124.2	97.5	111.2	109.1	300.0
<i>Treasury Bills</i>	27.2	18.7	39.0	57.3	89.9	176.3	626.3	1300.0
<i>Short-term Advances</i>	0.0	0.0	36.7	0.0	52.1	152.9	0.0	0.0
<i>Long-term government stocks</i>	0.0	0.0	0.0	291.3	291.3	291.3	590.7	590.7

<i>Revaluation Stocks</i>	0.0	0.0	0.0	0.0	0.0	0.0	1302.4	130
Government Dom. Bonded Debt (excl. Rev. Stock)	54.0	48.2	122.9	473.0	531.1	732.0	1326.4	219
CEPA Estimated Payment Arrears	<i>na</i>	<i>na</i>	<i>na</i>	<i>na</i>	<i>na</i>	<i>na</i>	978.0	36
CENTRAL GOVERNMENT DOMESTIC DEBT	54.0	48.2	122.9	473.0	531.1	732.0	3606.8	386
Domestic Interest Payments	5.8	10.6	24.9	94.3	166.4	232.9	434.5	64
Total Revenue	267.3	390.7	366.3	724.2	1261.3	1784.8	2268.5	267
Total Expenditure	264.0	351.6	510.7	821.8	1149.6	1714.5	2604.0	384
Deficit (-) / Surplus (+)	3.4	39.1	-144.4	-97.6	111.7	70.3	-335.4	-117
Nominal GDP (¢ billion)	1,920.8	2,427.5	2,802.9	3,674.9	4,950.4	7,418.0	10,633.1	14,30
<i>Government Domestic Bonded Debt as % of:</i>								
<i>GDP</i>	2.8	2.0	4.4	12.9	10.7	9.9	24.7	2
<i>Revenue</i>	20.2	12.3	33.5	65.3	42.1	41.0	115.9	13
<i>Real Govt. Dom. Bonded Debt at 1997 prices</i>	3.4	2.6	6.0	17.2	14.4	11.6	31.4	3
<i>Govt Dom. Bonded Debt (in billion US \$)</i>	0.17	0.13	0.28	0.73	0.56	0.62	1.61	1
<i>Govt Dom. Bonded Debt (excl. Rev. Stock) as % of:</i>								
<i>GDP</i>	2.8	2.0	4.4	12.9	10.7	9.9	12.5	1
<i>Revenue</i>	20.2	12.3	33.5	65.3	42.1	41.0	58.5	8

Sources: Bank of Ghana Annual Reports and Government of Ghana Budget Statements

Appendix 2: External and Domestic Debt

	1980	1983	1985	1990	1992	2000
Total External Debt (million \$)	1,398.00	1,666.00	2,256.00	3,873.00	4,499.00	6,038.10
Long-Term Debt	1,162.00	1,242.00	1,365.00	2,808.00	3,345.00	5,391.30
Use of IMF-Credit	105.00	331.00	701.00	745.00	740.00	282.40
Short-Term Debt	131.00	93.00	190.00	320.00	414.00	363.60
Total External Debt per head (\$)	130.29	139.77	177.36	257.86	282.60	324.63
Domestic Debt (billion cedis)	7.62	29.32	37.77	44.98	122.88	7,842.30
Total Domestic Debt per capita (¢)	710.34	2,459.31	2,968.95	2,994.47	7,718.28	421,629.03

Sources: Various issues of the World Bank's *World Debt Tables*, and the Bank of Ghana's *Quarterly Bulletins*