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FINANCING CAPITAL PROJECTS IN GHANA: THE CHOICE OF EUROBONDS OVER LOANS FROM INTERNATIONAL DEVELOPMENT PARTNERS

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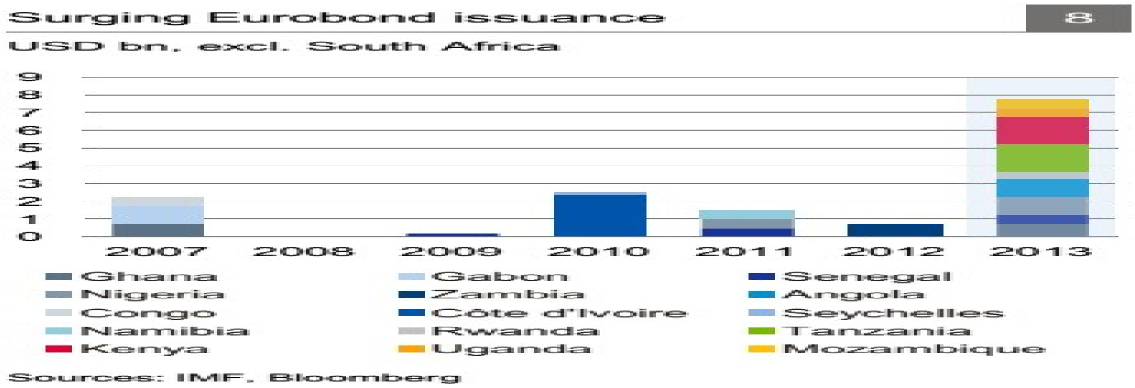
Abstract
This paper exploresthevariousreasonsorfactorsbehindusing Eurobondas against loans fromdevelopment partnerssuch astheWorld Bank (WB), International Monetary Fund (IMF) and the African Development Bank (AfDB), in financing capital projects in Ghana. Inaddition, the paper examinestheimpactofhowthesefactorscouldpredictthefinancialchoice aswellasthevariousmeasuresputinplacetobenefitfromusingthistype ofdebtinstrument.

Introduction
Mostsub-SaharanAfrican countrieshavehad to relyheavily on foreign assistanceorloansfrominternational financialinstitutionstosupplyand financemany projects.Butnow,duetotheimprovementintheireconomic performanceand theincomestatus,many ofthesecountries,suchasGhana, arefindingnewsourcestofinancetheirprojectstocreatejobs andpromote development. There hasbeentheproliferationofEurobondsontheAfrican continentforthepastyears(asseeninthefigurebelow).



Thisreaffirmsthatthechoiceordecisionofgoing forEurobondsoverthe otherdebt instrumentsamong developingcountries(especiallyexisting and potential issuance)still needslengthy analysisandmoreresearch attention. Forthisreason, theimportanceofthisstudy stemsfromit beinganattempt tofillthegapinliterature.Thestudy exploresthereasonsbehindthepolicy makers'decisionoftappingtheinternational bondmarketinrelationto financingcapital projects in Ghana.

2. Literature Review

2.1 Overviewof the internationalbond market

AEurobond isadebtinstrumentissuedsimultaneously toinvestorsina number ofcountries,outside the jurisdiction oftheissuer's country (Melnik&Nissim, 2006).This debt instrumentisdenominatedinforeigncurrencieslikeUS, pounds. Originally, themainborrowersin theEurobond marketwereinternational agencies, sovereign governmentsof developed countriesand majorbanks. Afterthemid-1980s,highqualitycorporateborrowers alsoenteredthe market. Inthemid-1990s,corporateborrowersbecamedominant(Melnik & Nissim,2006).Most corporateEurobondsareissuedbyfirmsfromthe financial services sector. During1980s,bondswith the initialmaturitybetween5 and10years accountedformorethan50%ofthetotalfacevalue.The Eurobond market grew rapidlyduring the 1990s.(Melnik&Nissim, 2006).

2.2 Foreign debts overdomestic debts andeconomic growth

There arereasons thatinfluencecountries to borrow more externallythan locally. Literaturehaspresentedsomeofthereasonsthat affectmany countries decision to chooseexternaldebt.For instance,Soludo (2006) opined thatcountriesborrowfor threebroad categories;macroeconomic reasonstoeitherfinancehigherinvestmentprojectsor higherconsumption andhard budget constraint.

2.3 Issuing internationaldebt instrument(Eurobonds)

Therearevariousreasonsthatmany countriesthatenterthebondmarket. Therearecostsand riskscountriesthatentertheinternationaldebt market face.Below are the some ofthe costs andbenefits.

2.3.1Cost and benefits

Theaugmentationof domesticsavingsisthemainreasonfor entering the bondmarket(Das, Papaioannou,&Polan,2008).Enteringthemarketof

Eurobondreducestheriskofcrowdingoutdomesticinvestorsfromthe marketandthussupportinggrowthanddevelopmentinthedomesticmarket whichincreasedomesticsavings. Thisprovesthefloatationtheorywhich statesthat, itisrationaltoborrowsmallerfundsfromwithinandhugecapital from the international bond market. This bond issuance should be in consistent withtheeconomicframeworkcan significantlypromotegrowth and prosperity in alleviating poverty and bridging developmental gaps existinginthe country(IMF, 2003& AFRODAD, 2013).

2.3.2Considerations for the issuance of external debt instrument.

According toDan,PapaioannouandPolan, therearevariousfactors that areconsidered indeciding issuance ofEurobonds.Thiswasmade on the assumption ofsustaining its debtlevel.Below someofthe factors;

I. *Size ofissue anduseof proceeds*
II. *Maturity, repaymentstructure andcurrencyof denomination*
III. *Asset andliabilitymanagementimplications*
IV. *Stronginvestor's relationship*

2.4Determinants of choosing(Euro) bondsover bank loans

There are few literatures that highlight the factors that borrowers or countriesconsidered beforeselecting eitherabondorloaninexternalfinancing ofitscapitalprojects.OneofthefewstudiesintheliteratureisGale's(2001) studyinwhich75countries(developinganddeveloped)databetween1991 and1999werecollectedandanalyzed.Hermodelexplainedtherelationship between the borrower's risk level and the choice of international debt instruments.TheexternaldebttoexportstoGDP,inflation,publicdebtto GDP,exportvolatilityratiosaswellasthepoliticalstabilityandtheexchange ratemovementsofthecountrywere someofthevariablesused.Thesevariablesaffectedthecreditratingresiduala ndthefinancial development of the borrower.Itwasconcludedthatborrowersfromcountrieswithhighrisk wouldfinditverydifficulttoborrowfromthebankbecauseoftheirhigh inflationrate,debttoGDP,debttoexportratioandliquidityissuesandthus would have to issue junk bonds to be able to raise funds on the internationalmarket.Whereascountrieswithlowriskwillalsoissuebonds, investmentgradebonds,duetoitsgoodeconomicindicators,countries withmoderateriskwillborrowfrombanks.Themodelwasbuiltonthe assumptionthatborrowerswouldchoosetheinstrumentwiththeleastcost ofborrowing.However, hermodel,assheadded,wasnotabletopredictthe behaviorsof sovereign countriesonthechoiceof debt instrument, because, mostsovereign countrieshad variousobjectivesof tappingtheinternational debtmarket. However, hermacroeconomic variablesusedwereconsistent withCantorandPacker(1996).Theyanalyzedthedeterminantsandimpact ofthecreditratingsamongthirty five (35)emergingcountriesin1995.It wasconcluded that thereweresix macroeconomicfactorsthat affected sovereignbondspreadsand ratings. These factorswereper capitaincome,GDP growth,inflation,external debt,thelevelofeconomicdevelopmentanddebt to GDP.

3. Data Analysisand Discussion ofResults

Eurobond issues management or strategy

Belowaresomeofthestrategiessetup by governmentin relationto Eurobonds issues.These include the following;

a) Startingwiththe2014Eurobonds,theannualbondprogram should besubmittedtoParliamentforprior-approval withtheannual budgets.
b) Establishinga capital market committeethatwouldadvise thegovernment on the market operationsin theinternational capital marketaswellasfindthebeststrategiesofmanagingsuchnew issues.Thiscommitteewill alsosupportGhana Infrastructural Fundwhichdealsinfindinginfrastructural projectsthat wouldyield jobcreation andgrowth.
c) Managing government debt issues, especiallyEurobond moreregularly(inthepublicdebtmanagementstrategy),soasto have anorderly financialbudget for specific projects.

Debt management in Ghana

Here are some the strategies proposed:

a) Allself-financed projectswouldbedesignedbasedonthecost benefitanalysis,thatis, how therevenuegenerated from theprojects couldoffset theloans.
b) Thedevelopmentofloans-top-priorityprojects, programs, which would help thegovernment identify specificprojectsthat could be funded withthe recentEurobonds andother sources ofcapital.
c) Shortterm borrowing wouldbesourcedonly forliquidity management the internationalcapitalmarket for capitalexpenditure.

The motives behindissuingEurobonds in financingcapital projects

According tothepolicy makers,theproceedsfromtheEurobondswouldbe usedtorestructure thedomesticmarket,repairbudgetissues,pay outstandingloansandfinance capital projects. When askedwhyEurobonds were selectedoverWorld Bankloans, respondentsfrom BOG and MOFEP agreedthatEurobondprovidedahugesourceofcapital tothecountryata lowerrate. Itwas further statedthat,themultilateralpartnerswhoare madethe World andAfricaDevelopmentBankcouldhavebeenchosenas thesourcetofinancetheinfrastructural projects.However,due tothehuge capital($1bn)thattheGovernmentofGhana wasexpected toraise,the multilateral partnerswereprepared to offerhalf,thus, their offer rejected. The availabilityof huge capitaloffered at a lower rate as compared to the domesticaswell astheinternational multilateral sourcesattheEurobond market,madeitrational forpolicymakerstoenterthe Eurobond market.Itwasalso furtherstatedthat, onacostbenefitanalysisprinciple,itwasrighttoissue Eurobondsatabout 8%thanborrowfrom thebank (internally) at23% asidethe huge capitalaccessibility andthe cheaper rate beingoffered, respondentsfromMoFEPandBOGagreedthatsomeofthespillovereffectof entering theEurobond marketwashavingastronginternational presence whichencouragesGhanatohaveastrongaccesstothecapital market.

Factors influencingexternalfinancing decision

RespondentsfromGIPC,MoFEPandBOG,all agreedthatmajoreconomic indicatorslikeGDP(PPP),inflation,global interestrate,external debttoGDP and export to external debt ratio were essential when considering any external debt source of capital. These factors affect the economic performanceofthecountryaswell ascredit ratingandinvestors'reactions. Besides, thetechnical advisorestablishedthat, theglobal interestrate,loancurrency,sizeoffundsandmaturityintermsofprojects arerelevantfactors when thegovernment of Ghanaintends to borrow externally.

Thetimingof Eurobonds (2007 and 2013): right or wrong?

Both respondents ofMOFEPand BOGmadeitclearthat, having astrongfinancial, economicand market disciplineshouldbeofmuch concernwhenpreparingtousesuch an instrument. Having a high disciplinein themarketisabout having sound economicindicators.The highinterestrate,highvolatilityandhugedebt (fiscal)burdendrivesoutinvestmentsandtheuseofsuchEurobondswill not beappropriatein such periods.FortheEurobondstoprovidetheexpected fundacountryneedstheremustbe astrongeconomic (indicator) performancethat would attractinternational investors.Astronger relationshipwithinvestorsshouldbeofmuchconcernwhen enteringthe international bondmarket.Bycreatingastrongrelationship,most‘anchor’ investorscould beconvincedintobuyingGhana’sbondsin times when the government defaultsorhas some economicchallenges.

Factors thathinderthesaleof Eurobonds

From thestandpointofthepolicymakers, internally,thebureaucratic proceduresinvolved in issuingEurobonds in thecountry,prevented the government from enjoyinglower interestratesin2013.

Otherexternal riskslikequantitativeeasingandLIBOR[1]rateaswell asthedepreciationofGhanaCedi arealsorisksthatcouldaffectthepriceof Ghana’sEurobond. An increaseinLIBORwouldincreasethe globalinterestrate, whichwouldaffecttheratesonIBRDloans,commercial bankloansand International bonds. Inreducingtheserisks,assaidbytherespondentfrom BOG, theonlymeasureput inplacetoreducethedepreciationof theGhana Cedi istheannouncement of theBOG to limittheuse of theUSdollarin the country.

Tothepolicyanalyst,theinterestrateisvery important when policy makers are decided to goinfor anyexternal debtcapitalinstrument.

Whathave been done? Andshould be done?

From thepolicy makers(perthe2013 and 2014 budget), therearesome policies orstrategies that are beingputin place to benefitfromanyEurobond issues.TheCapital MarketCommittee(CMC)andtheGhanaInfrastructural Fund(GIF)arecommitteesthatwould provideinformationorreportsonsomeofthemost priorityprojectsthatwouldbefinancedthroughEurobonds to help create jobs, promote development and manage the debt sustainabilitylevelofthecountry.However,duetothelongerbureaucracies, the strategies initiated for the issue of the next Eurobond was stooped.

Eurobondprocedure whichpreventedpolicymakersfromissuingearlierto enjoycheaperrate was concerned raised that Eurobond issuance to be approved by parliament of Ghana.

Fromtheanalystpointofview,governments shouldinvestinprojectsthat haverolling effects on theeconomy.

Conclusion

Inconclusion thereasonsforpolicymakersgoing totheEurobondmarket insteadofgettingloansfromIMF,WBand AfDBisalaudableoneand consistentwithliterature.TheEurobondsseemstobethebesttool for infrastructural orcapitalprojects,butifitisactuallyusedforunproductive purposes, thencompetitiveadvantage arepolicy makerstakenforusing Eurobondsasagainsttheother source of borrowing.Thedebt portfoliotoGDPisfastgetting closertothethresholdand thecountry couldfaceastrong rejectionfrom the bondmarketandevenbilateralpartners,sinceeconomicperformance andrating isgoing tobe affected.

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