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

Abstract
This paper explores the various reasons or factors behind using Eurobonds against loans from development partners such as the World Bank (WB), International Monetary Fund (IMF) and the African Development Bank (AfDB), in financing capital projects in Ghana. In addition, the paper examines the impact of how these factors could predict the financial choice as well as the various measures put in place to benefit from using this type of debt instrument.

Introduction
Most sub-Saharan African countries have had to rely heavily on foreign assistance or loans from international financial institutions to supply and finance many projects. But now, due to the improvement in their economic performance and income status, many of these countries, such as Ghana, are finding new sources to finance their projects to create jobs and promote development. There has been the proliferation of Eurobonds on the African continent for the past years (as seen in the figure below).
This reaffirms that the choice or decision of going for Eurobonds over other debt instruments among developing countries (especially existing and potential issuance) still needs lengthy analysis and more research attention. For this reason, the importance of this study stems from it being an attempt to fill the gap in literature. The study explores the reasons behind the policy makers’ decision of tapping the international bond market in relation to financing capital projects in Ghana.

2. Literature Review

2.1 Overview of the international bond market

A Eurobond is a debt instrument issued simultaneously to investors in a number of countries outside the jurisdiction of the issuer’s country (Melnik & Nissim, 2006). This debt instrument is denominated in foreign currencies like US, pounds. Originally, the main borrowers in the Eurobond market were international agencies, sovereign governments of developed countries and major banks. After the mid-1980s, high-quality corporate borrowers also entered the market. In the mid-1990s, corporate borrowers became dominant (Melnik & Nissim, 2006). Most corporate Eurobonds are issued by firms from the financial services sector. During the 1980s, bonds with the initial maturity between 5 and 10 years accounted for more than 50% of the total face value. The Eurobond market grew rapidly during the 1990s (Melnik & Nissim, 2006).

2.2 Foreign debts over domestic debts and economic growth

There are reasons that influence countries to borrow more externally than locally. Literature has presented some of the reasons that affect many countries’ decision to choose external debt. For instance, Soludo (2006) opined that countries borrow for three broad categories: macroeconomic reasons, either finance higher investment projects or higher consumption and hard budget constraint.

2.3 Issuing international debt instrument (Eurobonds)

There are various reasons that many countries that enter the bond market. There are costs and risks countries that enter the international debt market face. Below are some of the costs and benefits.

2.3.1 Cost and benefits

The augmentation of domestic savings is the main reason for entering the bond market (Das, Papaioannou, & Polan, 2008). Entering the market of
Eurobond reduces the risk of crowding out domestic investors from the market and thus supporting growth and development in the domestic market, which increases domestic savings. This proves the floatation theory which states that it is rational to borrow smaller funds from within and huge capital from the international bond market. This bond issuance should be in consistent with the economic framework can significantly promote growth and prosperity in alleviating poverty and bridging developmental gaps existing in the country (IMF, 2003 & AFRODAD, 2013).

2.3.2 Considerations for the issuance of external debt instrument.
According to Dan, Papaioannou, and Polan, there are various factors that are considered in deciding issuance of Eurobonds. This was made on the assumption of sustaining its debt level. Below some of the factors;

I. Size of issue and use of proceeds
II. Maturity, repayment structure and currency of denomination
III. Asset and liability management implications
IV. Strong investor’s relationship

2.4 Determinants of choosing (Euro) bond over bank loans
There are a few literatures that highlight the factors that borrowers or countries considered before selecting either a bond or loan in external financing of its capital projects. One of the few studies in the literature is Gale’s (2001) study in which 75 countries (developing and developed) data between 1991 and 1999 were collected and analyzed. Her model explained the relationship between the borrower’s risk level and the choice of international debt instruments. The external debt to export to GDP, inflation, public debt to GDP, export volatility ratios as well as the political stability and the exchange rate movement of the country were some of the variables used. These variables affected the credit rating residual and the financial development of the borrower. It was concluded that borrowers from countries with high risk would find it very difficult to borrow from the bank because of their high inflation rate, debt to GDP, debt to export ratio and liquidity issues and thus would have to issue junk bonds to be able to raise funds on the international market. Whereas countries with low risk will also issue bonds, investment grade bonds, due to its good economic indicators, countries with moderate risk will borrow from banks. The model was built on the assumption that borrowers would choose the instrument with the least cost of borrowing. However, her model, as she added, was not able to predict the behavior of sovereign countries on the choice of debt instrument, because, most sovereign countries had various objectives of tapping the international debt market. However, her macroeconomic variables used were consistent with Cantor and Packer (1996). They analyzed the determinants and impact of the credit ratings among thirty-five (35) emerging countries in 1995. It was concluded that there were six macroeconomic factors that affected sovereign bond spreads and ratings. These factors were per capita income, GDP growth, inflation, external debt, the level of economic development and debt to GDP.

3. Data Analysis and Discussion of Results
Eurobond issues management or strategy

Below are some of the strategies setup by government in relation to Eurobonds issues. These include the following:

a) Starting with the 2014 Eurobonds, the annual bond program should be submitted to Parliament for prior approval with the annual budgets.

b) Establishing a capital market committee that would advise the government on the market operations in the international capital market as well as find the best strategies of managing such new issues. This committee will also support Ghana Infrastructural Fund which deals in finding infrastructural projects that would yield job creation and growth.

c) Managing government debt issues, especially Eurobond moreregularly (in the public debt management strategy), so as to have an orderly financial budget for specific projects.

Debt management in Ghana

Here are some the strategies proposed:

a) All self-financed projects would be designed based on the cost-benefit analysis, that is, how the revenue generated from the projects could offset the loans.

b) The development of loans-topriority projects, programs, which would help the government identify specific projects that could be funded with the recent Eurobonds and other sources of capital.

c) Short term borrowing would be sourced only for liquidity management in the international capital market for capital expenditure.

The motives behind issuing Eurobonds in financing capital projects

According to the policy makers, the proceeds from the Eurobonds would be used to restructure the domestic market, repair budget issues, pay outstanding loans and finance capital projects. When asked why Eurobonds were selected over World Bank loans, respondents from BOG and MOFEP agreed that Eurobond provided a huge source of capital to the country at a lower rate. It was further stated that the multilateral partners who are multilateral partners who were prepared to offer half, thus, their offer rejected. The availability of huge capital offered at a lower rate as compared to the domestic as well as international multilateral sources at the Eurobond market, made it irrational for policymakers to enter the Eurobond market. It was also further stated that, on a cost-benefit analysis principle, it was right to issue Eurobonds at about 8% than borrow from the bank (internally) at 23% aside the huge capital accessibility and the cheaper rate being offered, respondents from MoFEP and BOG agreed that some of the spillover effect of entering the Eurobond market was having a strong international presence which encourages Ghana to have a strong access to the capital market.

Factors influencing external financing decision
Respondents from GIPC, MoFEP and BOG all agreed that major economic indicators like GDP (PPP), inflation, global interest rate, external debt to GDP and export to external debt ratio were essential when considering any external debt source of capital. These factors affect the economic performance of the country as well as credit rating and investors' reactions. Besides, the technical advisors established that, the global interest rate, loan currency, size of funds and maturity in terms of projects are relevant factors when the government of Ghana intends to borrow externally.

The timing of Eurobonds (2007 and 2013): right or wrong?

Both respondents of MOFEP and BOG made it clear that, having a strong financial, economic and market discipline should be of much concern when preparing to use such an instrument. Having a high discipline in the market is about having sound economic indicators. The high interest rate, high volatility and huge debt (fiscal) burden drives out investments and the use of such Eurobonds will not be appropriate in such periods. For the Eurobonds to provide the expected fund, country needs there must be a strong economic (indicator) performance that would attract international investors. A stronger relationship with investors should be of much concern when entering the international bond market. By creating a strong relationship, most ‘anchor’ investors could be convinced into buying Ghana’s bonds in times when the government defaults or has some economic challenges.

Factors that hinder the sale of Eurobonds

From the standpoint of the policymakers, internally, the bureaucratic procedures involved in issuing Eurobonds in the country, prevented the government from enjoying lower interest rates in 2013. Other external risks like quantitative easing and Libor rate as well as the depreciation of Ghana Cedi are also risks that could affect the price of Ghana’s Eurobond. An increase in LIBOR would increase the global interest rate, which would affect the rates on IBRD loans, commercial bank loans and international bonds. In reducing these risks, as assaid by the respondent from BOG, the only measure put in place to reduce the depreciation of the Ghana Cedi is the announcement of the BOG to limit the use of the US dollar in the country.

To the policy analyst, the interest rate is very important when policy makers are decided to go for any external debt capital instrument.

What have been done? And should be done?

From the policy makers (per the 2013 and 2014 budget), there are some policies or strategies that are being put in place to benefit from any Eurobond issues. The Capital Market Committee (CMC) and the Ghana Infrastructure Fund (GIF) are committees that would provide information or report on some of the most priority projects that would be financed through Eurobonds to help create jobs, promote development and manage the debt sustainability level of the country. However, due to the longer bureaucratic procedures, the strategies initiated for the issue of the next Eurobond were stumped.
Eurobond procedure which prevented policymakers from issuing earlier to enjoy cheaper rate was concerned raised that Eurobond issuance to be approved by parliament of Ghana.

From the analyst point of view, governments should invest in projects that have rolling effects on the economy.

**Conclusion**

In conclusion, the reasons for policymakers going to the Eurobond market instead of getting loans from IMF, WBG and AfDB is laudable one and consistent with literature. The Eurobonds seem to be the best tool for infrastructural or capital projects, but if it is actually used for unproductive purposes, then competitive advantage are policy maker taken for using Eurobonds as against the other source of borrowing. The debt portfolio to GDP is fast getting close to the threshold and the country could face a strong rejection from the bond market and even bilateral partners, since economic performance and rating are going to be affected.

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**Reference**


