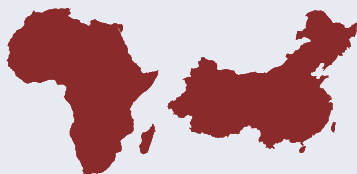


# POLICY BRIEF

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## WHAT HAPPENED TO CHINA DEVELOPMENT BANK'S \$3 BILLION LOAN TO GHANA?

BY THOMAS CHEN

After Ghana joined the “oil producers club” in 2010, the country secured a \$3 billion loan facility from the China Development Bank (CDB), collateralized with a portion of the country’s oil revenue, to finance major infrastructure projects. By 2015, Ghana had canceled half of the CDB loan facility. Disbursement of the CDB loan was painfully slow, and the urgently needed gas project financed under the loan had fallen far behind schedule. This policy brief explores the factors behind these developments, and outlines key lessons from this experience.

### THE \$3 BILLION LOAN FACILITY AND THE WESTERN CORRIDOR GAS PROJECT

As a former highly indebted poor country (HIPC) enjoying debt cancellation from the international financial institutions, Ghana was not supposed to take out large non-concessional loan finance. The government of Ghana (GoG) argued vigorously that as the country transitioned to middle-income status, it would gradually lose access to concessional financing from international donors. Since the CDB loan was non-concessional, the IMF board approved a one-time increase in Ghana’s annual non-concessional borrowing limit from \$800 million\* to \$3.4 billion in December 2011. While supporting the IMF’s decision, the World Bank also concluded that gas infrastructure deserved “the highest and most urgent levels of attention” because natural gas is an inexpensive source of fuel for Ghana’s current and future power plants. Thus, the first project to be funded by the CDB loan was the \$800 million “Western Corridor Gas Infrastructure Development Project” (WCGIDP), consisting of a 45 km offshore pipeline, a gas processing plant to treat the gas harnessed from the offshore oil field, and a 110 km onshore pipeline connecting the gas processing plant to power plants near Ghana’s major port city of Takoradi.

The contractual agreement for the WCGIDP was agreed to by five parties (the “Five Party Agreement”):

- 1) The Bank of Ghana (Ghana’s central bank), which is charged with maintaining the CDB debt service account;
- 2) Ghana National Petroleum Corporation (GNPC), which is an equity owner of the Jubilee field and, before the passage of the Petroleum Commission Act of 2011, was also the regulator of Ghana’s petroleum industry;
- 3) The China Development Bank;
- 4) Unipet Asia, a subsidiary of Sinopec involved in offshore exploration and production, as well as marketing and distribution of petroleum products; and
- 5) Ghana’s Ministry of Finance and Economic Planning (MOFEP).

With experience negotiating similar contracts in commodity-producing countries, CDB offered the Ghanaian government the ability to repay the \$3 billion loan through the collateralization of Ghana’s new-found offshore oil: Unipet Asia, a wholly-owned

**Table 1: China Development Bank Loan Structure**

	<b>Structure</b>
<b>Facility amount</b>	<i>Tranche A:</i> \$1.5 billion <i>Tranche B:</i> \$1.5 billion
<b>Repayment period</b>	<i>Tranche A:</i> 15 years <i>Tranche B:</i> 10 years
<b>Drawdown period</b>	<i>Tranche A:</i> 5 years <i>Tranche B:</i> 3 years
<b>Repayment terms</b>	Principal and interest every 6 months
<b>Interest rate</b>	<i>Tranche A:</i> 6 month LIBOR + 2.95 per annum (3.38% per annum as of Aug 2011) <i>Tranche B:</i> 6 month LIBOR + 2.85% per annum (3.29% per annum as of Aug 2011)
<b>Exposure fee</b>	0.25% of the loan
<b>Commitment fee</b>	1.0% per annum on the undrawn balance of the loan
<b>Content requirement</b>	60% Chinese
<b>Other requirements</b>	Maintaining a debt service account that contains a cover at least 1.5 times each repayment at all times 15% government counterpart funding for every project before loan dis-

subsidiary of Sinopec, signed an off-taker agreement with the Ghana National Petroleum Corporation (GNPC) to initially lift 13,000 barrels of crude oil daily, with the proceeds deposited in a debt service escrow account. The terms of the CDB loan also mandated that at least 60 percent of the proceeds be used to procure Chinese content, and that Ghana provide 15 percent counterpart funding for every CDB-financed project prior to loan disbursement for the project.

The Chinese government offered Sinopec the opportunity to be the turnkey Engineering Procurement and Construction (EPC) contractor for the WCGIDP—managed by the newly formed Ghana National Gas Company (GNGC). With all financing and operational aspects of the infrastructure packaged under one facility, the CDB framework provided the Ghanaians with an easy all-inclusive deal that obviated the need to conduct laborious and independent stages of tendering and financing negotiations.

The WCGIDP was officially completed in November 2014, almost a year behind schedule. The delay in implementation was largely due to the slow

disbursement of the CDB loan. Approximately one year after the scheduled completion date, only \$600 million had been disbursed—\$200 million short of the amount needed to complete the project. The Ghanaian government was so frustrated with the slow disbursement of the CDB loan that that President Mahama personally directed the Finance Minister to find alternative sources of financing either to replace the CDB facility for the project, or to serve as “bridge financing.”

The deterioration of Ghana’s external and fiscal position amid a global commodity downturn then contributed to the government’s decision to cancel half of the \$3 billion loan principal amount in July 2014, as well as all subsequent infrastructure projects associated with the first tranche of the loan.

**Why did the WCGIDP fall behind schedule? Why was the disbursement of the CDB loan so slow? And why did the Ghanaian government decide to forgo half of the CDB loan nearly four years after the original agreement was signed?** Although the answers to these questions are not entirely clear due to conflicting stories from the government, media, and think tanks, institutional and regulatory constraints, local politics, poor management of the project, weak absorptive capacity, and fiscal and external challenges all contributed to the eventual collapse of a portion of the CDB loan facility.

### **CAPACITY CONSTRAINTS, MISMANAGEMENT AND INTERNAL OPPOSITION**

The National Democratic Congress (NDC), led by former President John Atta Mills, informally secured the loan—subject to IMF and Parliamentary approval—in September 2010 on a Presidential trip to China. By taking on such a large loan without proper due diligence or political preparation, the Ghanaian government alienated the opposition party, donors, members of the civil society, and local communities.

**From the beginning, the opposition accused the ruling party of rushing the CDB loan approval process without Parliamentary scrutiny of the financial agreements—including the Ghana National Petroleum Corporation’s (GNPC) 15 year off-taker agreement with Unipeac Asia for the supply of 750 million barrels of crude oil for the purpose of debt service, amounting to approximately 13,000 barrels per day. Moreover, the opposition exposed that the World Bank was willing to finance the gas infrastructure project at concessional terms, but the ruling party did not consider the offer seriously because of laborious requirements for procurement and environmental, labor, and social**

impact assessments. Apparently, the Ghanaian government wanted to complete negotiations on a financing structure for the gas project in six months—an impossible timeline for the World Bank. Furthermore, the prospects of a close re-election campaign in 2012 may have prompted the Mills administration to fast-track the approval of the WCGIDP and financing agreements associated with the CDB loan.

**“By taking on such a large loan without proper due diligence or political preparation, the Ghanaian government alienated the opposition party, donors, members of the civil society, and local communities.”**

In addition, civil society and think tanks allied with the opposition party objected to the government’s creation of a new, state-owned enterprise, the Ghana National Gas Company (GNGC), specifically to oversee the WCGIDP and future CDB-financed projects. The opposition accused GNGC of poor financial management: allegedly it signed over-priced contracts with Sinopec for the construction of the gas processing plant and a 25-year off-taker agreement for the sale of liquefied petroleum gas with a little-known, private Ghanaian company. These accusations made it difficult for GNGC to manage Sinopec, which had more international clout and experience. GNGC’s inability to negotiate an acceptable raw gas purchase agreement with the multinationals producing oil off the coast of Ghana also delayed the WCGIDP. GNGC was eventually absorbed into the national oil company, GNPC.

**Under political pressure, the ruling party tried to appease internal resistance to the CDB loan by attempting to renegotiate its terms.** This decision was prompted in part by the revelation that the original CDB financing agreements may have been inconsistent with the country’s own petroleum revenue management (PRM) law, a regime instituted to help Ghana avoid the resource curse plaguing other oil-dependent African countries. The inconsistencies include:

- The 15 year off-taker agreement with Unipeac Asia for the collateralization of Ghana’s oil revenue for debt service purposes;
- Transferring 70 percent of the proceeds of every crude oil lifting directly into the CDB debt service account, instead of dividing the proceeds among the annual budget account, the debt service account, and the sovereign wealth funds; and
- The requirement that projects have at least 60 percent Chinese content, including selecting Sinopec as the turnkey contractor for the gas processing project,

which conflicts with Ghana’s 2013 “local content regulations” that require foreign oil and gas companies to source input from Ghanaian businesses, select Ghanaian sub-contractors, and ensure Ghanaian equity participation in all oil/gas related projects.

Gas processing plant construction site, Ghana



Photo credit: Thomas Chen

## **FISCAL WOES FORCE GHANA TO GO BACK TO THE IMF AND CANCEL THE CDB LOAN**

In addition to internal opposition, Ghana’s deteriorating fiscal and external situation also forced the government to revisit the cost of continuing to draw on the CDB loan facility. Even before the precipitous drop of the price of Brent crude oil from \$115 in June 2014 to \$53 in January 2015, large declines in the price of gold and cocoa had already contributed to a \$1.3 billion drop in foreign exchange earnings for Ghana in

**“Ghana’s rising external debt and growing fiscal deficit jeopardized the government’s plans to secure the counterpart funding required for the timely disbursement of the CDB loan, and pay the annual commitment fee.”**

2013, leading to a current account deficit of 12 percent of GDP for the year. The shock to the terms of trade led to a sharp depreciation of Ghana’s currency, which caused the public external debt stock (in local currency) to balloon by 27 percent in the first six months of 2014 alone. Ghana’s fiscal deficit rose from around 5 percent of GDP in 2011, when the CDB loan agreement was signed, to 10.5 percent of GDP by 2014. This jeopardized the government’s plans to secure

the counterpart funding required for the timely disbursement of the CDB loan, as well as to continue paying the annual 1 percent commitment fee on the undrawn balance of the \$3 billion loan.

With both the external debt stock rapidly rising and potential liquidity issues emanating from a large cash deficit, the terms of the CDB loan came under greater scrutiny. When the value of the fixed quantity of oil exports dropped significantly, CDB sent a delegation to Ghana to negotiate an increase in the number of barrels of oil collateralized for debt service from 13,000 to 15,000 barrels per day. With the global drop in oil prices, the Chinese side was determined to lower the fixed price they paid for crude oil going into the escrow account for debt service to \$85 per barrel, while the Ghanaians insisted that the price be maintained at \$100 per barrel, which had been the benchmark price set by the Ghanaian government for its own annual revenue projection purposes since 2011. Ghana's finance minister calculated that the \$15 difference in the per barrel price would have meant that Ghana would pay \$6.4 billion to repay the \$3 billion loan, equivalent to a 6 percent per annum interest-rate loan. Ghana refused to budge on the price, even though the finance minister stated in 2012 that the "off-taker agreement calls for the use of average prices that will be adjusted periodically." The precarious fiscal deficit and external debt situation ultimately drove the Ghanaian cabinet to cancel \$1.5 billion of the \$3 billion CDB loan principal amount.

When it agreed to allow Ghana to take a non-concessional loan from CDB in 2011, the IMF did not have a clear picture of Ghana's ability to manage its fiscal and external position, which resulted in an overly optimistic projection of the country's debt profile for the medium term. For instance, in the November 2011 debt sustainability analysis (DSA) conducted to incorporate the \$3 billion CDB loan, the IMF projected that by 2016, the country's present value of debt-to-GDP ratio would be 25.4 percent, when in reality it was 43 percent in 2015. After the commodity price shock, Ghana had significantly fewer fiscal resources available to continue debt service and pay the necessary counterpart funding for loan

disbursements. This was a wake-up call for both the Ghanaian government and the IMF. In April 2015, the two agreed on a new three year \$918 extended credit facility with ambitious targets.

## POLICY RECOMMENDATIONS

Ghana should take four primary lessons from its CDB experience to improve its ability to negotiate, structure, manage, and implement large infrastructure projects supported by external non-concessional financing:

- 1) **Political management:** Political opposition to the CDB loan demonstrates the importance of garnering support from all stakeholders before approving a large non-concessional external loan, as the opposition party's relentless criticism hindered the government's timely implementation of the WCGIDP project.
- 2) **External guidance:** Neither the World Bank nor any other bilateral or multilateral donor assisted Ghana in the loan negotiation, subsequent renegotiation, or project implementation process. The involvement of such a third-party may have helped catch the clauses in the CDB financing agreements that were inconsistent with existing regulations. Thus, Ghana should consider enlisting third-party guidance in future agreements so proper due diligence can be conducted.
- 3) **Institutional capacity:** Opposition to the creation of the Ghana National Gas Company and its difficulties managing the WCGIDP stresses the importance of building an institution with adequate capacity to oversee a major infrastructure project.
- 4) **Mitigate price shocks:** The IMF's debt sustainability projections may miss unanticipated global commodity turns that can severely affect the country's external and fiscal positions. When the external environment is favorable, commodity exporters like Ghana should build external and fiscal policy buffers to mitigate against the inevitable cyclical price shock.

\*All dollar figures in USD unless otherwise noted

The content of this brief does not reflect the official view or opinion of the State Department. An extended version of this paper with references is forthcoming as a CARI Working Paper.

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