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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 86/156

10:00 a.m., September 15, 1986

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	Mawakani Samba
	M. K. Bush
	G. Seyler, Temporary
	M. B. Chatah, Temporary
	T. Morita, Temporary
	B. Goos
Huang F.	
J. E. Ismael	
	J. R. N. Almeida, Temporary
	R. Fox, Temporary
	O. Isleifsson, Temporary
	G. D. Hodgson, Temporary
	A. Abdallah
	J. J. Dreizzen, Temporary
	L. P. Ebrill, Temporary
	J. E. Rodríguez, Temporary
	V. Rousset, Temporary
J. J. Polak	
	A. V. Romuáldez
	B. Tamami, Temporary
	A. Vasudevan, Temporary
	L. Tornetta, Temporary

L. Van Houtven, Secretary
L. Collier, Assistant

Also Present

A. Sayeh, Advisor, Ministry of Finance of Liberia. IBRD: D. Berk, Western Africa Regional Office. African Department: A. D. Ouattara, Director; N. Abu-zobaa, E. A. Calamitsis, J. Damon, C. Enweze, E. K. Martey. Central Banking Department: H. Mehran. Exchange and Trade Relations Department: E. H. Brau, F. L. Osunsade, N. Streefkerk. Fiscal Affairs Department: M. Frenkel. Legal Department: H. Elizalde, A. O. Liuksila. Treasurer's Department: J. E. Blalock. Personal Assistant to the Managing Director: R. M. G. Brown. Assistants to Executive Directors: A. Bertuch-Samuels, F. Di Mauro, J. M. Jones, M. Lundsager, H. van der Burg.

1. LIBERIA - 1986 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1986 Article IV consultation with Liberia (SM/86/205, 8/18/86). They also had before them a report on recent economic developments in Liberia (SM/86/212, 8/25/86).

Miss Antoinette Sayeh, Advisor in the Ministry of Finance of Liberia, was also present.

The staff representative from the African Department said that, according to data gathered during a Fund staff visit to Liberia in August, the Government's overall fiscal deficit, on a commitment basis and including grants, was estimated to have amounted to about $100 million in 1985/86, or more than 9 percent of GDP, compared with $91 million envisaged at the time of the consultation discussions. The increase had been due to both lower revenues and higher expenditures.

On the external side, there were indications that in 1985/86 the current account surplus had been larger than estimated in the staff report, mainly because of lower imports, but net capital outflows had also been larger, the staff representative reported. Thus, the overall balance of payments deficit had reached almost $110 million in 1985/86, as indicated in the report, entailing an increase in external arrears to an unprecedented high level. The spread between the official and parallel market exchange rates had apparently continued to widen.

Mr. Abdallah made the following statement:

> The Liberian authorities are appreciative of the opportunity that the consultation has provided for a frank exchange of views between themselves and the staff, especially at this time when the Government has embarked upon a serious effort to chart new directions for the economy. The broad range of economic indicators contained in the two background papers along with the staff's analysis leave no doubt as to the seriousness of Liberia's economic problems.
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> The authorities would like to assure the Board that they remain aware that firm corrective actions are necessary, with no sector of the economy being spared, given the deep-rooted imbalances that have emerged in recent years, and they look forward to continued close cooperation with the Fund, other multilateral institutions, and friendly countries in their endeavor to find appropriate solutions to their economic and financial problems.
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> As Directors are well aware, adverse external developments have played an important role in the deterioration of the Liberian economy in recent years. The facts speak for themselves: during the five-year period ended December 1985, Liberia's terms of trade deteriorated by close to 10 percent;

the real effective exchange rate appreciated by 40 percent between 1980 and 1985, making the country's exports, particularly timber, less competitive on the world market; and high interest rates aggravated the burden of servicing the country's external debt. This is the background to the emergence of the rapid buildup of external arrears in the 1980s. The authorities, meanwhile, acknowledge that internal factors, including deficiencies in past policies, have contributed to the problems. Accordingly, recent discussions with the staff have been focused on those areas in which changes in policy would be most effective in stabilizing the economy and in enabling it to be in a better position to cope with external shocks.

The authorities are now fully convinced that given Liberia's dollar-base monetary arrangements and the openness of the economy, a prudent budgetary policy must remain central to their adjustment effort. As would be expected, the inability to use the exchange rate as a policy instrument has intensified the burden of fiscal adjustment, especially as Liberia has experienced a substantial decline in economic activity. Action to restrain the growth of public expenditure has included drastic cuts in wages and salaries of public service personnel, to the point where by the end of 1985 such payments were in nominal terms barely equal to the prevailing levels before 1980; the reduction in the work force; and the freezing of allotments for various categories of expenditure, including public works. In addition, institutional reforms have been implemented aimed at strengthening expenditure control and abolishing extrabudgetary expenditures.

On the revenue side, determined efforts are being made to broaden the tax base--especially income taxes--and to strengthen tax administration. With regard to the latter, the Ministry of Finance is taking steps to improve the revenue intake from the oil refinery and to ensure that the surplus accruing to the refinery owing to the drop in the price of oil is collected by the Government. Directors might be interested to know that the recommendations made by the staff in the course of the discussion in Monrovia in May aimed at strengthening the revenue position of the Government are under active consideration by the relevant authorities, and specific action may be expected.

Fundamental reform of public enterprises remains a cardinal goal of the Government's adjustment effort, the intention being to eliminate subsidies and to create opportunities for expanding the private sector. Decisions have already been taken to sell a number of these entities to the private sector. In addition, the authorities have plans for undertaking comprehensive audits of these enterprises, with the help of external experts. Already, arrangements for audits of the two most important public corporations, the Liberia Produce Marketing Corporation and the

Liberia Petroleum Refining Corporation, by international accounting firms are being finalized with the assistance of the U.S. Agency for International Development. A Bureau of State Enterprises was established about a year ago, and just about two weeks ago a Privatization Commission was established with a view to providing direction for the Government's reform program.

The medium-term outlook for the Liberian economy remains worrisome. The scenarios presented in the staff report have served to highlight the magnitude of the problem, and in so doing have intensified the resolve of the authorities to rekindle the momentum of the adjustment process, which was the hallmark of earlier years. The projections have also concentrated the authorities' attention on the necessity of implementing policies aimed at expanding the productive base of the economy and increasing exports. The authorities are convinced that adjustment and growth must go together in view of the precipitous decline in per capita income over the last five years and the rapid increase in the growth of the population.

In mapping a medium-term growth strategy, the authorities recognize that the role of the exchange rate must be given due consideration and that a determination on this matter is an important prerequisite for prudent action. It is for this reason that they have requested assistance from the Fund in evaluating the prevailing currency system with a view to receiving appropriate recommendations in the light of present realities. The seriousness with which the Government views the present monetary and banking crisis is evidenced by the audience granted the mission by the highest political authorities, including the President of the Republic. The authorities have indicated that they await the recommendations of the mission with great interest.

An important conclusion of the staff is that even in the face of strong adjustment measures Liberia would require substantial financial support from creditors and donors if it is to stabilize its external payments position. It is the hope of the authorities that such assistance would be forthcoming to supplement what is being done on the domestic front to improve the mobilization and management of public resources.

Finally, the Liberian authorities would like to assure the Board of their firm commitment to normalizing their relations with the Fund and other creditors as soon as possible. They wish to stress once again that the buildup of arrears to the Fund has not been deliberate but was due to the tight foreign exchange position of the Government. Since April this year, the authorities have intensified their efforts to reactivate the special accounts that had been established to be used for servicing external debt. It is their hope that with effect from the fourth quarter of this year, reasonable amounts will be placed in these accounts so that Liberia will be able to resume repayments to the Fund. The authorities have expressed their intention to use about $7 million from the Economic Support Fund grant from the United States to make a partial payment to the Fund soon, and they have undertaken to make regular payments thereafter from their own resources.

Mr. Goos said that he welcomed the attendance of the Liberian representative at the meeting; it was an encouraging indication of the authorities' desire to maintain good relations with the Fund and of their intention to reconsider their present policy stance with a view to adopting a strong and comprehensive adjustment program and settling their arrears to the Fund without delay. Over the previous one and one half years, the Board had discussed repeatedly the necessary policy corrections, and the staff had again made a compelling case for an immediate comprehensive stabilization effort. He commended the authorities for the recent implementation of important measures, notably in the fiscal area--including the planned privatization of public enterprises--and their readiness to consider the reform of the exchange rate system. Those measures and initiatives undoubtedly were important steps in the right direction, especially as they addressed the fundamental causes of the existing economic difficulties. Nevertheless, the staff's analysis, particularly in the framework of the medium-term scenarios, clearly showed that much more needed to be done.

While the authorities seemed to be prepared to strengthen their efforts, he was unsure whether the necessary sense of urgency existed, Mr. Goos commented. Unfortunately, his doubts were reinforced by Mr. Abdallah's statement, for example, that "prudent budgetary policy must remain central to their adjustment effort." He considered that budgetary policy had a long way to go before it could be described as prudent. Accordingly, he agreed with the staff that a substantial further tightening of the fiscal policy stance would be essential.

In addition, Mr. Goos continued, the necessary reform of the exchange rate system deserved to be pursued more vigorously than suggested by Mr. Abdallah when he stated that "in mapping a medium-term growth strategy...the role of the exchange rate must be given due consideration." Moreover, in view of the size and duration of Liberia's overdue obligations to the Fund, the authorities' stated intention to settle only $7 million in the foreseeable future and to make only partial payments thereafter was extremely disquieting. Such partial payments would not only be disproportionate to the country's obligations to the Fund but would be bound to seriously delay the normalization of Liberia's relations with its external creditors. Given the prospective persistence of external financing gaps even in the face of more effective adjustment measures and, hence, the critical need to mobilize external funds, the authorities would be well advised to attach the highest priority to a prompt settlement of the existing overdue obligations to the Fund.

He strongly endorsed the repeated recommendation of the staff and of the Executive Board that the Liberian authorities should implement without any further delay a vigorous and comprehensive adjustment program as a prerequisite for economic recovery and growth, Mr. Goos concluded.

Mr. Fox remarked that the staff report revealed that the Liberian authorities had still not implemented the far-reaching and comprehensive adjustment program that the rapidly worsening financial situation called for, despite the continual urging of the Fund staff and the Executive Board over the previous year. Meanwhile, arrears to the Fund had continued to increase--with no payments made during 1986--and they were rapidly approaching a level where clearance would present insuperable problems to the formulation of any new Fund program.

The need for action was therefore increasingly urgent, Mr. Fox stated. The 1985/86 budget was ambitious, and if it had been implemented as planned it would have made a significant contribution to restoring financial stability and creditworthiness. However, the policies that had been put in place were inadequate, notwithstanding some important cuts in the public sector wage bill. The outturn for the budget deficit at 9 percent of GDP, although considerably less than in 1984/85, was still unsustainable and unfinanceable.

It was therefore regrettable that the 1986/87 budget foresaw another sizable deficit and displayed little recognition of the realities of Liberia's economic and financial situation, Mr. Fox continued. The authorities had not attempted to limit spending to the availability of finance, and no room had been made for a reduction in arrears. Moreover, specific measures to contain the deficit at that level were lacking. As a minimum, the budget should reflect the need to limit onshore spending to onshore receipts and to use offshore receipts for external debt service payments and the reduction in arrears. He asked the staff to comment on the size and distribution of the previous year's offshore receipts and on the likely proceeds from the new foreign exchange surrender law and their disposition. Local businesses were apparently unhappy with the operation of the new law, and he joined the staff in urging the authorities to ensure immediate payment in acceptable form of the domestic counterpart of any foreign exchange surrendered.

The authorities should implement the staff's detailed fiscal recommendations in full, while ensuring that revenue collection and expenditure control were improved, Mr. Fox said. In that connection, an end to revenue earmarking would be helpful, and he welcomed its planned elimination by the authorities.

So long as the Liberian dollar remained linked to the U.S. dollar, fiscal policy would be the key instrument of economic adjustment, Mr. Fox stated. However, in view of the departure from full convertibility and of the substantial premium on U.S. dollars, he would be interested in any preliminary views of the staff on where the advantage lay between retaining or abandoning the link to the dollar in the light of the recent technical assistance mission to look into that question. Urgent action on the fiscal front was needed regardless of the outcome of that study.

He continued to hold the view that technical assistance to countries in arrears to the Fund should focus on providing advice in drawing up measures that could bring about improvement in the member's financial situation and the elimination of its arrears, Mr. Fox concluded. He therefore welcomed the authorities' intention to continue a dialogue with the Fund staff with the objective of developing the necessary adjustment program; however, the authorities would have to show more willingness to follow the Fund's advice than they had done to date if it was to reach a successful conclusion.

Mr. Polak commented that Liberia's economic position was unfortunate. Rampant government expenditure had led to a large accumulation of arrears, and the external debt service ratio pointed to a bleak situation. External debt was almost equal to GNP, net Fund credit outstanding amounted to 22-25 percent of GNP, and external arrears were equivalent to about 20 percent of GNP and over 60 percent of the current year's export receipts.

A severe liquidity crisis had developed, reflected in the virtual disappearance of U.S. dollar notes from circulation, demonstrating the working of Gresham's law, Mr. Polak continued. The situation was further exacerbated by major data deficiencies. Moreover, the external environment was expected to remain unfavorable. The most important factor, however, was internal policies, and he welcomed Mr. Abdallah's statement that the authorities acknowledged that deficiencies in past policies had contributed to the problem. In those circumstances, a stronger and more comprehensive adjustment program was urgently needed. The staff recommendations were correct, but he saw no evidence that the Government was actually moving in that direction.

The link to the U.S. dollar, which in the past had performed a useful disciplinary function, was at present hopelessly compromised and could not be restored, Mr. Polak stated. In light of past inflation, a devaluation from parity to the U.S. dollar was called for. He hoped that the recent technical assistance mission would produce helpful suggestions in that regard.

The Government showed little sign of willingness or ability to cope with the situation, and the problem of arrears remained unsolved, Mr. Polak remarked. Under the circumstances, he wondered whether the generosity of the Fund was appropriate. There had been three staff missions to Liberia during the current year. In addition to the Fund resident representative, two experts in the banking field and a consultant on external debt provided by the Central Banking Department were in the country. He agreed that it was important to keep the channels of communication open, but perhaps that could be accomplished with the use of less staff time. New technical assistance missions should not be undertaken unless the authorities show real determination in solving their economic problems, evidence of which had not been shown thus far.

Mr. Hodgson made the following statement:

> The staff has given us a clear assessment of Liberia's bleak economic prospects, and I fully support its appraisal. The staff report leaves little doubt that the extremely difficult circumstances now facing the Liberian authorities are largely of their own making. Contrary to a point made by Mr. Abdallah, it should also be emphasized that the appreciation of the real effective exchange rate is not an exogenous factor but rather the consequence of a discrete policy decision by the authorities to link their monetary system to the U.S. dollar.
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> As the medium-term outlook demonstrates, Liberia's prospects at present are bleak, making the implementation of a comprehensive and unwavering adjustment effort imperative. The staff states that "in the absence of a strong and comprehensive adjustment effort, it appears that the economy will continue to stagnate, financial imbalances will remain unsustainably large, and domestic and external payments arrears will reach unprecedentedly high levels." The staff also emphasizes that even if production and exports are increased significantly, average real GDP will show little, if any, increase over the next five years. These are disturbing prospects for any economy, let alone for one that has already experienced half a decade of decline. The Liberian authorities have only one course of action if they are to restore economic growth--not to mention meeting their external obligations, including those to the Fund--and that is to adopt the thorough and comprehensive policy package described in the staff paper.
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> A monetary system where the Liberian dollar is pegged to the U.S. dollar at par was supposed to provide strong financial discipline within the Liberian economy. Clearly, that has not been the case. A statutory limit on central bank financing of fiscal deficits might have strengthened financial discipline, but even such a statutory limit would not work if the authorities are prepared to mint coins in order to provide credit to the public sector. The authorities have asked for technical assistance from the Fund in reassessing their monetary system, and such assistance should be provided. However, I agree with Mr. Polak that any new system--such as creation of an independent Liberian currency, which would permit devaluation against the U.S. dollar--cannot begin to solve Liberia's problems without the authorities first adopting a credible attitude toward fiscal policy. Ultimately, it is not the monetary system that provides financial stability in any economy; it is the consistent and rational behavior of the fiscal and monetary authorities.

The staff has outlined the possible remedies for Liberia's fiscal difficulties. I would simply like to emphasize that the fiscal position must be seen as credible by all economic agents in Liberia and abroad if the situation is to stabilize. To establish credibility, the authorities must not only reduce the fiscal deficit in 1986/87 to 4-5 percent of GDP, as recommended by the staff, but must also make their policy actions known to the Liberian people. There can be no repetition of the 1985/86 budget, which apparently was never published. In that regard, the pro forma budget for 1986/87 envisages a fiscal deficit exceeding 8 percent of projected GDP, which will only add to the erosion of the economy. Continuation of the current policy line is a clear choice in favor of no growth, falling real GDP, and economic stagnation through the medium term. Only through strong and unwavering fiscal action will financial stability be restored and credit be made available to the private sector for directly productive investment.

Finally, I would impress upon the authorities the need to deal forcefully with their overdue obligations to the Fund. No realistic measure of assistance from this organization or from other donors and creditors can be expected until the authorities have adopted the comprehensive policies called for by the staff. I agree with other speakers that stronger efforts to meet Fund obligations are called for.

Ms. Bush made the following statement:

Over a year ago during Liberia's 1985 Article IV consultation discussion (EBM/85/112, 7/24/85), we described a dismaying set of developments and a discouraging outlook for improvement in the Liberian economy. Particularly alarming was the growth in arrears to the Fund and other creditors. This year we find that the situation has worsened and that the authorities are moving in a gradualistic and piecemeal fashion to address some of the problems, leaving unresolved the growing financial crisis. We understand that the Minister of Finance was here for discussions last week. We would appreciate any comments that the staff or Mr. Abdallah might have regarding the likelihood of Liberia tackling its severe economic problems.

The inadequate budget is the central area of policy shortcoming. Athough there was an attempt to prepare an austere budget last year, it was not implemented and the deficit exceeded 9 percent of GDP. Expenditures remained high and revenues fell far short of projections, as has happened many times in the past. In light of the weak revenue performance, more of an effort was needed to reduce expenditures further; instead external arrears accumulated. As a result, Liberia has little remaining in terms of external sources of support. In that regard, we find it dismaying that after having told us over a year and a half ago that a special account for debt service payments would be set up, funded with offshore receipts, no payments have been made to the Fund since 1985. The lack of action and progress suggests that the Liberian authorities have little interest in resuming normal relations with external creditors and donors.

These developments are disappointing and make it clear that the Liberian authorities are watching the further deterioration of the economy and are taking no decisive actions to restore stability. A most obvious sign of this deterioration is the breakdown of the currency system shown by the disappearance of U.S. dollar notes from circulation. Even Liberian coins, which we understand exchange at a substantial discount from parity, apparently are being hoarded. The authorities have requested a study of the options for the currency system, and the Fund technical assistance mission has just come back, but we cannot imagine that the Liberian authorities will be able to return to a dollar standard, at parity, given the severe financial imbalances that are evident. In fact, it is important that the authorities implement a far-reaching adjustment program with due speed; there is no room for a gradualistic approach. We would welcome any comments by the staff or Mr. Abdallah on this issue.

The authorities have once again ordered that no extrabudgetary spending will be permitted. We welcome the new effort, but a period of successful implementation will be required to convince government agencies that this is indeed the case. We also question whether the targeted increase in revenues of some 31 percent can be attained, in light of consistent shortfalls in revenues in the past. The authorities apparently paid off some domestic arrears this year, and thus we would expect that some entities would be able to pay their taxes. Strong efforts to improve administrative capabilities to secure collections are, however, needed. Despite those intentions, the pro forma budget for 1986/87 projects a deficit that is substantial in relation to GDP, with little financing in sight and an overall financing gap of $145 million, a staggering figure, which leads us to conclude that domestic and external arrears will grow by similar amounts.

The one small bit of good news is the authorities' plan to privatize a number of public enterprises. These entities have been a drain on the public sector for some time; we hope that will end now. Unfortunately, we have yet to see concrete evidence of these intentions.

One policy measure that we are somewhat reluctant to endorse is the use of export surrender requirements. In most countries we take the need for such requirements as a sign that something is amiss and that incentives for voluntary conversion of foreign exchange into local currency are inadequate. In the present case, however, this may be a moot point as the Liberian authorities must have local currency to purchase what is being surrendered and, in light of the very weak budgetary position, we question whether budgetary resources will be available to buy this foreign exchange.

The full burden of proof is on the Liberian authorities at this time to demonstrate that they are serious about their intentions to adjust. Without that demonstration through actual policy implementation over an extended period, external creditors and donors cannot be expected to resume their historical role in the development process. It is particularly disturbing that the authorities have made no payments to the Fund since last year. Surely some sign of their intent, as expressed in Mr. Abdallah's statement, could have been made earlier and from the Liberians' own resources.

Mr. Chatah commented that he was in agreement with the staff appraisal. The proposed decision referred to external payments arrears that "may give rise" to restrictions on current international transactions; the 1985 decision had included the same wording. He asked the staff to clarify whether those arrears actually constituted restrictions.

The staff representative from the African Department observed that the Liberian authorities needed to adopt urgently a strong and comprehensive adjustment program designed not only to address the immediate and most pressing problems of the economy but also to ensure progress toward economic and financial viability over the medium and long term. To be successful, such a program would require basically three elements: first, major improvements in the mobilization and management of public resources; second, restoration of Liberia's external competitiveness and promotion of economic recovery and growth; and third, substantial and coordinated external assistance, including cash grants and generous debt relief.

Although precise figures were not available, indications were that the onshore budget deficit had amounted to $60-65 million in 1985/86, the staff representative continued. The staff had stressed the importance of limiting onshore expenditure to the level of available onshore revenue, with a view to providing maximum possible resources to meet Liberia's external debt service obligations.

It was premature at the present stage to answer the question of whether the link to the dollar should be retained or abandoned, the staff representative said. Although the current situation could be considered irreversible, the matter needed to be examined carefully. The currency study mission had just returned from Liberia, and its report would be ready for submission to the authorities in three to four months. Implementation of the foreign exchange surrender requirement had not yet started, as the authorities faced difficulties in mobilizing the necessary local resources to effect the exchange; there was also resistance by some key enterprises to that particular initiative.

The Liberia Petroleum Refining Company faced organizational and managerial problems, and the authorities were making efforts to privatize the refinery, the staff representative stated. In view of the prevailing retail prices for petroleum products and of developments in the world oil market, the potential existed in Liberia for the mobilization of considerable resources from that sector which could help improve the overall fiscal situation and reduce arrears.

Although Liberia had been declared ineligible to use Fund resources, the staff representative from the African Department noted, it was important to maintain contact and to assist the authorities in formulating policies that could redress the country's very serious, economic and financial situation. Of course, the authorities should also give encouraging signals to the Fund that would allow the staff to pursue a meaningful policy dialogue and provide technical assistance. To date there had been no shortage of goodwill on the part of the Fund in that regard, and there had been a number of staff missions to Liberia. The currency study, which was a key element of Fund assistance, could be particularly useful to the authorities. The three experts from the Central Banking Department--two with the National Bank of Liberia and one with the Ministry of Finance--were providing much needed technical assistance. The Liberian authorities had also approached the World Bank and the European Communities for technical assistance, notably in the areas of revenue mobilization and expenditure control, and their requests were under consideration.

The staff representative from the Legal Department explained that the decision had been drafted to reflect the fact that there had been no finding of restrictions imposed on payments and transfers for current international transactions. The first paragraph of the proposed decision did not refer to exchange measures subject to approval under Article VIII, Section 2(a). The staff would have to evaluate the Liberian situation again in light of evolving circumstances to determine whether the U.S. dollar continued to serve as legal tender in Liberia. If in future the staff determined that the National Bank of Liberia issued monetary assets that could be treated as currency and were found to be inconvertible into foreign currency at the request of the holder, there could be a conclusive finding of an exchange restriction.

A few members of the Fund did not formally issue their own currency, and in all those cases the staff had considerable difficulty in applying the Articles, which were largely based on the concept of one country-one currency, the staff representative from the Legal Department stated. For the next Article IV consultation with Liberia, he hoped that the staff could propose a decision that stated the situation clearly.

Mr. Abdallah said that he appreciated speakers' frank comments on the situation in Liberia. During the recent visit by the Minister of Finance, he had participated in informative discussions with the staff of the African Department. Continued contact between the staff and the Liberian authorities was essential--particularly during the previous year when the Governor and Deputy Governor of the National Bank and the Minister of Finance had changed--to explain the gravity of Liberia's position and of the continuing problem of arrears. From the Fund's point of view, the staff mission and the currency study helped the authorities to realize the seriousness of the situation. During the forthcoming Annual Meetings the Minister of Finance would again meet with the staff. However, the problem remained of convincing the other authorities in Liberia of the appropriate priorities.

The authorities deserved commendation for their fiscal measures, Mr. Abdallah stated. The reductions in salaries and wages that had taken place and the retrenchment in the civil service had been drastic. The results were obvious in Liberia. Salary payments had sometimes been delayed for three months to remain within the budget, and the level of income was low.

A change in the use of the U.S. dollar as a medium of exchange would be a major decision--both emotionally and economically--Mr. Abdallah remarked. Nevertheless, circumstances seemed to indicate that a change from the parity relationship was inevitable.

The wording in the communication from the Minister of Finance to the Managing Director (EBS/85/257, Sup. 4, 1/21/86) had been perhaps infelicitous, Mr. Abdallah recalled. The question of arrears to the Fund was important to the authorities as they realized the key role played by the Fund. But their position in determining how to distribute a small monetary balance was difficult, and the Minister of Finance and the Governor of the National Bank were not the sole decision makers.

The process of privatization of the oil refinery was moving very quickly, Mr. Abdallah commented. Upon completion of that transaction, $80-100 million could be released, allowing a sizable reduction of arrears, including a somewhat more than $7 million payment to the Fund. The authorities intended to sell other parastatals.

The exchange surrender requirement had been introduced recently and could possibly hasten a decision on changing the currency system, because the authorities must decide what currency would be given for the foreign exchange, Mr. Abdallah said.

In the present grave situation of Liberia, his comments might not be satisfactory, but he urged the Fund to stand ready to send technical assistance missions as requested, Mr. Abdallah remarked. Advice from trusted organizations was important for solving the worsening economic situation, while advice from other sources might not be helpful to anyone.

He would communicate the Board's comments to the Liberian authorities, and he believed that they would exhibit a stronger will toward thorough and stringent adjustment measures.

The Chairman commented that at present the Fund should assist the Liberian authorities in formulating the difficult policy measures that must be taken in the areas of currency reform, financial institutions, and the exchange rate, and in establishing a mix of firm fiscal and monetary policies. Nevertheless, the lack of action by the authorities was disappointing, and if it continued the Fund should reconsider the intensity and level of its technical assistance. Meanwhile, tangible manifestations of the authorities' intention to improve their financial relations with the Fund were called for.

The Chairman then made the following summing up:

Executive Directors agreed with the thrust of the staff appraisal in the report for the 1986 Article IV consultation with Liberia. They noted with regret the continued downward slide of the economy, the persistence of large financial imbalances, and the rapid accumulation of both domestic and external payments arrears--including arrears to the Fund--to unprecedentedly high levels. Moreover, the functioning of the monetary and banking system has been greatly impaired and confidence in the economy has been eroded, as evidenced by substantial capital flight, the virtual disappearance of U.S. dollar notes from circulation, and an overall balance of payments deficit in 1985/86 equivalent to some 10 percent of GDP, which is unsustainable.

Directors were of the view that, although some corrective measures had been taken in late 1985 and early 1986, the Liberian authorities had approached the country's problems in a much too gradualistic and piecemeal fashion. They had yet to demonstrate a firm resolve to come to grips with Liberia's very serious economic and financial difficulties. Directors therefore urged the authorities to adopt without delay a strong and comprehensive adjustment program designed not only to address the immediate problems but also to ensure progress toward economic and financial viability over the medium run.

Directors observed that the financial discipline that should have resulted from strict adherence to a monetary system under which the Liberian dollar is pegged at par to the U.S. dollar had been compromised by excessive, and often unproductive, government spending, financed through sizable bank borrowing and increasing issuance of Liberian coins. They noted that the generally unsettled environment had contributed to the disappearance of U.S. dollar notes and the liquidity crisis in the economy. Directors emphasized the need for a realistic and flexible exchange rate policy that could lead to the efficient use of scarce foreign exchange resources in the short run, to a more effective channeling of foreign currency resources into official circuits, and to the improvement of the competitiveness of the traded goods sector in the medium run. However, Directors also stressed that such a policy would be meaningful only if coupled with appropriate demand management measures.

Directors noted with concern that the progress made toward fiscal adjustment in 1985/86 was inadequate and that the Government's overall fiscal deficit remained unsustainably large. They therefore regretted that the 1986/87 budget implied an overall fiscal deficit, on a commitment basis, equivalent to more than 8 percent of projected GDP, representing practically no change compared with 1985/86. Directors recommended that every effort be made to improve government revenue collection, strictly limit budgetary expenditure, and avoid extrabudgetary outlays; some of the measures recently taken in this regard were steps in the right direction, but Directors considered that there was need for much stronger efforts by the authorities to restore fiscal discipline.

Directors took note of the Liberian authorities' intention to wholly or partially privatize certain public enterprises and to improve the operational efficiency of others. They emphasized the need to quickly translate these plans into action.

For almost a year, despite repeated assurances to Liberia's creditors, the Government had made no real effort to discharge its external debt service obligations, including those to the Fund, Directors noted. They expressed deep regret over Liberia's continuing failure to clear its overdue financial obligations to the Fund and again urged the authorities to make full and prompt settlement of those obligations, as the continued accumulation of arrears to the Fund could only make the problem more intractable.

In sum, unless and until strong and credible adjustment measures were adopted, Liberia would continue to lose the cooperation of the international community, and the country's economic situation would deteriorate further. All speakers thus concluded that it was of the utmost importance for the authorities to formulate and implement comprehensive adjustment policies promptly.

It is expected that the next Article IV consultation with Liberia will be held on the standard 12-month cycle.

The Executive Board then took the following decision:

1. The Fund takes this decision in concluding the 1986 Article XIV consultation with Liberia, in the light of the 1986 Article IV consultation with Liberia conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes that the authorities of Liberia appear not to have imposed restrictions on payments and transfers for current international transactions, but that external payments arrears have emerged, as described in SM/86/205, which may give rise to such restrictions. The Fund urges the authorities to eliminate these payments arrears as soon as possible.

Decision No. 8392-(86/156), adopted
September 15, 1986

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/86/155 (9/12/86) and EBM/86/156 (9/15/86).

2. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAP/86/219 (9/11/86) is approved.

APPROVED: May 27, 1987

JOSEPH W. LANG, JR.
Acting Secretary