FOR AGENDA

SM/85/188

CONTAINS CONFIDENTIAL
INFORMATION

June 28, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Liberia - Staff Report for the 1985 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1985 Article IV consultation with Liberia, which will be brought to the agenda for discussion on a date to be announced. A draft decision appears on page 26.

Mr. Syvrud (ext. 6974) or Mr. Enweze (ext. 8650) are available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

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Department Heads

CONTAINS CONFIDENTIAL INFORMATION

INTERNATIONAL MONETARY FUND

LIBERIA

Staff Report for the 1985 Article IV Consultation

Prepared by the Staff Representatives for the 1985 Consultation with Liberia

(In consultation with the Fiscal Affairs, Legal, and Treasurer's Departments)

Approved by A.D. Ouattara and Eduard Brau

June 26, 1985

I. Introduction

The 1985 Article IV consultation discussions were held in Monrovia February 6-20, 1985, in Washington March 25-26, 1985, and again in Monrovia April 30-May 10, 1985. The consultation discussions included consideration of measures necessary to settle promptly Liberia's overdue obligations to the Fund. The last Article IV consultation discussions were held in December 1983, and the staff report was considered by the Executive Board on April 6, 1984 (EBS/84/54, March 12, 1984). A stand-by arrangement for a period of 18 months in the amount of SDR 42.78 million, or 60 percent of quota, was approved by the Fund on December 7, 1984 (EBS/84/234, November 19, 1984).

Liberia's stand-by arrangement is currently inoperative, and the first review of the program has not been concluded. Liberia is unable to purchase under the arrangement because it has exceeded the ceilings on net credit from the banking system to Government (an excess of $37 million at end-April 1985) and external arrears (an excess of an estimated $65.5 million at end-April 1985), including arrears to the Fund of SDR 20.9 million at end-April 1985. A report on Liberia's overdue obligations to the Fund (EBS/85/87, April 4, 1985) was considered by the Executive Board on April 24, 1985. On May 24, 1985, the Executive Board limited Liberia's ability to use Fund resources until Liberia has become current in its obligations to the Fund (EBS/85/133, May 22, 1985). As of May 31, 1985 the Fund's holdings of Liberian dollars subject to repurchase amounted to SDR 211.2 million or 296.1 percent of quota, of which SDR 36.1 million or 50.7 percent of quota were under the CFF. Also as of May 30, 1985, overdue obligations to the Fund amounted to SDR 24.4 million. Liberia's relations with the Fund are outlined in Appendices I and II.

Liberian participants in the consultation discussions included Mr. A. Jones, Minister of Finance; Mr. E. Gardiner, Minister of Planning and Economic Affairs; Mr. T.D.V. Hanson, Governor of the National Bank of Liberia; Mr. F. Sherman, Director of the Budget Bureau; and other senior economic ministers and officials. The staff representatives were Messrs. D. Syvrud (head-AFR), K. Dublin (AFR), C. Schiller (FAD), P. Stella (ETR), and Mrs. A. Selassie (secretary-AFR). Also participating in the follow-up mission in May were Mr. C. Enweze (AFR), Mr. G.R. Kincaid (ETR), and Ms. J. Smart (Secretary-ADM). Mr. A. Linde, the Fund resident representative in Liberia, participated in all the consultation discussions. Mr. J.M. Jones, Technical Assistant in the Office of the Executive Director for Liberia, participated in some of the meetings during the February mission. Staff missions collaborated at all stages with overlapping missions from the World Bank, which is in the process of negotiating a Structural Adjustment Credit (SAC) of $32 million. The objectives of the SAC and its current status are described in Section III; the World Bank's relations with Liberia are provided in Appendix III.

Liberia continues to avail itself of the transitional arrangements of Article XIV.

II. Background

The Liberian economy is recovering at a modest rate from the 1981-83 recession. After three years of declining output, the economy began to pick up in 1983/84 and appears to be growing at an estimated rate of 2 percent in 1984/85; however, per capita income continued to decline (Table 1). The rate of inflation is running at about the same rate (2 percent) as in 1983/84.

During the three fiscal years 1980/81 to 1982/83, the Government of Liberia made little progress in correcting the domestic and external imbalances confronting the economy. Adjustment in the fiscal accounts occurred only in FY 1983/84. In FY 1982/83, government spending amounted to $390 million, or 37 percent of GDP; in FY 1983/84, spending had been reduced to $332 million, or 30 percent of GDP, although there appears to have been some increase in expenditure arrears. As revenues and grants remained relatively stable, the overall deficit fell from 13 percent of GDP in FY 1982/83 to 7 percent in FY 1983/84. Regarding the balance of payments, the deficit in the current account declined from $107 million (or 10 percent of GDP in 1980/81) to $88 million (or 8 percent of GDP in 1982/83) and $61 million (or 6 percent of GDP in 1983/84).

Liberian performance during these years should be viewed in the context of several unfavorable factors, both of an external nature and induced by domestic policies: an unsustainable increase in the wage bill, resulting from the doubling of the minimum wage and a sharp increase in the number of public sector employees following a change in Government in April 1980; a large external debt service burden, partly associated with

Table 1. Liberia: Selected Economic and Financial Indicators, 1980/81-1984/85 1/

	1980/81	1981/82	1982/83	1983/84	1984/85 Program	1984/85 Estimates
	(Annual percentage change, unless otherwise specified)					
National income						
GDP at constant prices	-3.4	-0.7	-8.1	0.9	3.9	2.3
GDP at current market prices	2.1	2.5	-4.9	2.5	5.1	4.7
Consumer prices	10.0	7.0	4.7	1.6	3.7	2.5
External sector						
Exports, f.o.b.	-7.0	-8.3	-11.2	-3.5	8.4	-0.9
Imports, c.i.f.	-3.3	-9.2	-10.3	-8.0	6.6	-6.4
Non-oil imports, c.i.f.	-7.1	-13.1	0.9	--	6.6	-5.7
Export volume	-7.5	-1.0	-9.9	-3.5	7.5	0.3
Import volume	-13.4	-8.0	-7.0	-6.0	3.8	-9.2
Terms of trade (*deterioration* -)	-9.9	-6.3	2.4	0.4	-2.0	-1.8
Nominal effective exchange rate (appreciation)	7.3	14.8	8.4	8.4	...	22.4 2/
Real effective exchange rate (appreciation)	5.6	12.0	6.4	4.0	...	12.6 2/
Government budget						
Revenue and grants	7.4	15.3	-7.9	1.2	11.5	-17.3
Total expenditure	19.5	-1.3	5.4	-14.9	4.2	17.2
Money and credit						
Domestic bank credit	-9.7	34.7	16.4	16.5	-3.3	9.1
Government (net)	(44.2)	(40.0)	(46.0)	(15.9)	(--)	(11.7)
Public corporations (net)	(280.5)	(146.2)	(-60.4)	(59.2)	(-91.7)	(22.7)
Private sector	(-49.1)	(3.0)	(-12.8)	(9.2)	(12.1)	(-6.5)
Money and quasi-money	-15.1	10.3	8.5	8.9	7.9	-1.0
Interest rate (annual rate on one-year deposits)	10.3	10.9	10.0	10.0	10.0	10.0
	(In percent of GDP)					
Government overall deficit 3/	12.1	8.1	12.5	6.7	4.9	15.2
Foreign financing	5.9	3.7	4.0	3.5	3.7	4.4
Domestic bank financing	3.5	4.5	7.6	3.7	--	3.2
Gross domestic investment	16.4	14.3	11.8	10.3	20.0	9.6
Gross domestic savings	19.0	17.2	14.3	14.4	17.8	15.5
External current account deficit						
Excluding official grants	...	15.4	17.8	14.0	15.6	11.7
Including official grants	9.8	6.7	8.2	5.6	6.9	5.8
External debt (including use of Fund credit)	55.8	66.0	80.0	84.3	87.5	89.5
	(In percent of exports of goods and services)					
Debt service ratio						
Before rescheduling	...	13.0	19.0	25.5	29.7	33.5
After rescheduling	6.7	8.2	13.4	17.3	22.1	25.4
Interest payments	4.4	7.4	11.1	11.5	12.1	13.3
	(In millions of U.S. dollars)					
Overall balance of payments deficit	46	43	68	33	--	58
Gross official reserves	8	9	7	5	5	2
External payments arrears (end of period)	10	2	14	5	--	80
Domestic arrears (end of period)	...	...	...	45 4/	...	92

Sources: Data provided by the Liberian authorities; and staff estimates and projections.

1/ Fiscal year July to June.
2/ June-March actuals.
3/ On a checks-issued and commitment basis prior to 1984/85, and strictly commitment basis thereafter.
4/ Level of domestic arrears established after approval of program. Program targeted no increase in domestic arrears.

expenditures for the OAU Conference in 1978/79 and partly with the rising interest rate levels in international financial markets; the recession in the industrial nations, which weakened the markets for Liberia's main exports, rubber and iron ore; and finally, the substantial real appreciation of the Liberian currency, which further weakened the competitive position of Liberian exporters and discouraged diversification of the export base.

Presidential elections are scheduled for November 8, 1985, and the inauguration of the new president will take place in January 1986. A new constitution was approved by referendum on July 3, 1984, and as the first step toward return to constitutional rule, the Head of State announced on July 22, 1984 the dissolution of the People's Redemption Council (PRC), which had governed Liberia since April 1980, and the formation of an Interim National Assembly, which includes 14 members of the PRC and 35 civilians selected on the basis of regional representation. Under present arrangements, major economic and financial measures are debated and approved by the Assembly before being presented to the Head of State for final approval.

III. Recent Economic Development

Liberia's financial structure is in a precarious state. Unchecked fiscal imbalances and withdrawals of deposits from the banking system have created a severe liquidity shortage, a fragmentation of the banking system, and an accumulation of public sector payments arrears, both domestic and foreign. In this context, the Government of Liberia was unable to observe two of the quantitative performance criteria in the current stand-by arrangement with the Fund, which is now inoperative. The ceilings on net claims of the banking system on the Government and external payments arrears, including arrears to the Fund, have not been observed since the end of December 1984.

The principal targets in the 1984/85 program included a real GDP growth rate of 4 percent (compared with 1 percent in the previous year), a continued reduction in the overall deficit of the Government, and a modest improvement in the balance of payments. A summary of the policy measures to achieve the program objectives and the status of their implementation are provided in Table 2. Performance under the quantitative performance criteria is shown in Table 3.

1. Output, prices, and incomes

After three years of declining output, the Liberian economy grew somewhat in 1983/84 and 1984/85, not preventing, however, a decline in GDP per

Table 2. Liberia: Summary of Program Under Stand-By Arrangement for 1984/85 and Status of Implementation

1. Principal targets

	1983/84 Actuals	1984/85 Program	1984/85 Rev. proj.
		(In percent)	
Real GDP growth	0.9	3.9	2.3
Change in consumer prices	1.6	3.7	2.5
	(Before debt relief; in percent of GDP)		
Balance of payments			
Current account deficit	-5.6	-6.9	-5.8
Overall deficit	-5.1	3.2	-8.3
Government financial operations			
Overall deficit (commitment basis)	-6.7	-4.9	-15.2
Domestic bank financing	3.7	--	3.2

2. Principal policy measures

Program	Status of implementation
a. Fiscal measures	
(1) New measures to reduce wage bill by $5 million.	A $10 monthly check deduction was introduced on October 1, 1984. The retirement of employees 65 years and older was started, but not the voluntary retirement scheme.
(2) New tax measures to yield $11 million.	A monthly payroll tax of $5 was introduced on October 1, 1984. A 5 percent import surcharge to yield $4 million on annual basis was not implemented on October 1, 1984 as stated in the letter of intent, but an across-the-board increase in all import duties by 10 percentage points was implemented on May 1, 1985. All ad hoc duty-free privileges granted to corporations were eliminated on July 6, 1984, but reinstated in November 1984 at 50 percent of their previous level contrary to statements in the letter of intent, and eliminated on March 19, 1985. The gasoline excise was raised from $1.25 to $1.50 per gallon on May 1, 1985, but collections are negligible.
(3) Improved enforcement of tax collections	Task forces organized to collect back taxes, real estate taxes, customs duties, income taxes, stampage fees, and gasoline excises, but results to date are minor.
(4) Improve budget control	Budget allotments were not reduced as revenue collections fell, but were released on basis of original budget.
(5) Bank clearing arrangement	Renewed May 10, 1985.
(6) Avoid new domestic arrears	Domestic arrears data collected systematically for first time. Stock of arrears was about $45 million on June 30, 1984, and increased by an estimated $47 million in FY 1984/85.
b. Public corporations	
(1) Rationalize public enterprises	Being implemented in cooperation with World Bank. Four corporations offered for sale; one already sold and second has prospective buyer. Also, LPRC has been restructured to distribution company.
c. Monetary and credit policies	Performance criteria on credit to Government not observed (see Table 3).
d. External measures	
(1) No external arrears	External arrears rose to $26 million at end-December 1984.
(2) Rescheduling of debt service due in 1984/85 to Paris Club and London Club	London and Paris Clubs signed on in December 1984.
(3) No restrictions on payments and transfers for current transactions	Incurred external payment arrears.
(4) Contract no external debt of 1-12 years in excess of $15 million and no loans of 1-5 years except refinancing of existing loans.	Performance criteria observed (see Table 3).

Table 3. Liberia: Quantitative Performance Criteria for 1984-86 Stand-By Arrangement

(In millions of dollars)

	1984 June	1984 Dec.	1985 Mar.
Net domestic assets of NBL 1/			
Actual	218.9	215.3	212.6
Ceiling		219.0	219.0
Net claims of banking system on Government 2/			
Actual	300.0	309.6	313.3
Ceiling		300.0	300.0
Net claims of NBL on public corporations			
Actual	6.2	5.2	5.3
Ceiling		6.0	6.0
Outstanding external payments arrears			
Actual	5	2.6	58.4
Ceiling	--	--	--
New external borrowing contracted or guaranteed by government or NBL			
a. 1-12 years' maturity			
Actual	...	0	0
Ceiling	...	15	15
b. 1-5 years' maturity			
Actual	...	0	0
Ceiling	...	--	--
c. less than 1 year's maturity			
Actual	...	0	4
Ceiling	...	12	12

Source: Letter of intent.

1/ Net domestic assets are defined as equivalent to the net foreign liabilities of the NBL, excluding gains and losses derived from exchange rate changes since June 30, 1984.

2/ Based on information provided by the Liberian authorities prior to adjustments made to NBL credit figures in April 1985. April data show credit to Government from the banking system at $355.0 million.

capita in every year since 1980. The rate of inflation has declined to less than 2 percent, compared with an average inflation rate of 7 percent over the preceding three years, and this low rate is continuing into 1985.

The growth rate of 1 percent in 1983/84 is attributable primarily to an increase in agricultural output, exclusive of rubber and forestry (Table 4). Production in the subsistence sector is estimated to have increased by 3-4 percent in 1983/84, due mainly to an expansion in rice production. Output in the export-oriented sector, however, declined by approximately 1 percent despite an estimated 45 percent increase in the production of cocoa. Most of this decline is explained by the fall in production of iron ore (2 percent), coffee (28 percent), forestry (2 percent), and rubber products (2 percent).

During 1984/85, preliminary estimates indicate that positive growth will be recorded in all agricultural commodities. In the subsistence sector agricultural output is projected to increase by about 4 percent. In the export-oriented sector agricultural output is also projected to increase by an estimated 4 percent due to substantial increases in rubber and coffee production and smaller increases in cocoa and forestry production. Overall growth in the export sector, however, is influenced by developments in the mining sector where production is projected to continue its decline by 1.0 percent.

2. Budgetary performance

On the basis of data for the first nine months, the budget deficit for FY 1984/85 (on a commitment basis) is estimated at $174 million, or 15.2 percent of GDP, compared with a deficit of $56 million, or 4.9 percent, projected in the original budget (Table 5). Revenue fell an estimated $32 million below the level of the previous fiscal year. Expenditures, on the other hand, exceeded the level of the previous fiscal year by $57 million. It is estimated that expenditure arrears will increase by $85 million (8 percent of GDP) so that the overall deficit on a cash basis will be $89 million. The cash deficit is primarily covered by foreign financing, including debt relief of $33 million, but an estimated $37 million was financed by borrowing from the domestic banking system.

The shortfall in revenues of $53 million from the programmed level is explained in part by a slower growth of GDP and a lower level of imports and, therefore, lower customs duties than projected for FY 1984/85. But the major explanation lies in a failure to collect taxes fully and to implement programmed tax measures. Revenue and grants are estimated to decline to 18.8 percent of GDP, compared with 23.7 percent in 1983/84; this is the weakest revenue effort in over five years. A monthly payroll tax of $5 per employee, a suspension of all ad hoc duty-free privileges granted to corporations, and a 5 percent import surcharge, to be implemented on October 1, 1984, were expected to generate 1 percent of GDP in

Table 4. Liberia: Gross Domestic Product, 1980/81-1984/85

(Percentage changes from preceding year at constant prices)

	1980/81	1981/82	1982/83	1983/84	1984/85
	Estimates				Proj.
Export-oriented sectors	0.3	1.1	-19.5	-1.0	0.9
Agriculture	-10.7	-2.1	-8.9	0.9	4.2
Mining and quarrying	5.9	2.8	-24.7	-2.1	-1.0
Domestic-oriented sectors	-8.0	-3.7	-3.5	0.5	1.2
Total monetary economy	-4.5	-1.5	-10.3	0.3	1.8
Total subsistence economy	2.8	3.0	2.5	3.6	4.0
Total GDP	-3.4	-0.7	-8.1	0.9	2.3

Sources: Data provided by the Liberian authorities; and staff estimates and projections.

Table 5. Liberia: Summary of Government Fiscal Operations, 1980/81-1985/86 1/

	1980/81	1981/82	1982/83	1983/84	1984/85		1985/86
	Actuals				Budget	Revised estimate	Pro forma budget
				(In millions of dollars)			
Revenue and grants	242	279	257	260	290	215	259
Revenue 2/	218	238	224	224	245	192	225
Grants 3/	24	41	33	36	45	23	34
Expenditure 4/	375	370	390	332	346	389	354
Recurrent	236	287	261	237	257	238	253
Wages	(138)	(158)	(136)	(126)	(121)	(125)	(117)
Interest	(32)	(37)	(57)	(63)	(67)	(71)	(77)
Others	(66)	(92)	(68)	(48)	(69)	(42)	(59)
Development	124	96	96	73	89	62	101
Local	(59)	(63)	(61)	(35)	(39)	(21)	(41)
Foreign 5/	(65)	(34)	(35)	(38)	(50)	(41)	(60)
Nonbudgetary 6/	8	12	17	9	--	15	--
Unallocated expenditure (net) 7/	7	-25	16	13	--	74 8/	--
Overall balance 9/	-133	-91	-133	-72	-56	-174	-95
Identified expenditure arrears 10/	7	-6	8	-7	--	85	-35
Overall deficit: cash basis	-126	-97	-125	-79	-56	-89	-130
Financing	126	97	125	79	56	-89	-34
Foreign	65	42	43	38	56	52	26
Drawings	(67)	(46)	(44)	(45)	(77)	(57)	(91)
Repayments	(-16)	(-29)	(-29)	(-40)	(-53)	(-38)	(-65)
Debt relief	(14)	(25)	(28)	(33)	(32)	(33)	(...)
Domestic	61	55	82	41	--	37	-60
Banking 11/	(39)	(51)	(82)	(41)	(--)	(37)	(-54)
Nonbank	(22)	(4)	(--)	(--)	(--)	(--)	(-6)
Gap	--	--	--	--	--	--	164
Memorandum items:							
	June '81	June '82	June '83	June '84		June '85	
Expenditure arrears (stocks)	...	...	...	47		133	
Interest	(7)	(1)	(9)	(2)		(41)	
Wages	(...)	(...)	(...)	(19)		(22)	
Goods and services	(...)	(...)	(...)	(26)		(70)	
Principal repayment arrears (stocks)	3	1	5	3		39	
				(In percent of GDP)			
Revenue and grants	22.1	24.9	24.1	23.7	25.2	18.8	21.3
Expenditure 4/	34.3	33.0	36.7	30.3	30.1	34.0	29.2
Overall balance 9/	-12.1	-8.1	-12.5	-6.7	-4.9	-15.2	-7.8
Domestic bank financing	3.5	4.5	7.6	3.7	--	3.2	-4.9

Sources: Data provided by the Liberian authorities; and staff estimates.

1/ Fiscal year begins July 1.

2/ Including gasoline excise taxes collected by LPRC, and not transferred to Government, but for which there was an agreement to offset these amounts by cancelling corresponding obligations of the Government to the LPRC. No such agreement has been reached for FY 1984/85. An estimated $18 million in revenues from the gasoline excise tax is not included in the revenue figure.

3/ Excludes grant-in-kind.

4/ Up until 1984/85, this is on the basis of checks entered into the cash book; except for wages, petroleum purchases, and interest payments, which are on a commitment basis. Since 1984/85 it is on a commitment basis.

5/ Excludes expenditures financed by grants-in-aid.

6/ Includes carry-over of commitments from previous year.

7/ Calculated as residual; includes unrecorded expenditure and financing items, change in paycheck arrears, and check float along with statistical discrepancies.

8/ Comprises identified increase in payment commitments to vendors of $26 million and $48 million in unidentified outlays, which were derived residually. The unidentified expenditure includes the counterpart to the recently made upward revision in credit to Government for which detailed information is not yet available.

9/ Up until 1984/85 this is a mixture of a checks-issued and a commitment basis. Since 1984/85 it is on a commitment basis. Deficits prior to 1983/84 may be underestimated because data on the accumulation of domestic arrears are unavailable. Similarly, the underlying budget deficit for 1984/85 would be $18 million or 2 percentage points of GDP lower if the LPRC had fully transferred the gasoline excise revenues owed to the Finance Ministry.

10/ Up until 1984/85 includes only interest arrears.

11/ Does not include $17.8 million in credit to Government, which was extended to the Government in the period before June 30, 1984, but for which an allocation among fiscal years is not yet possible.

revenue. However, contrary to intentions expressed in the authorities' letter of intent dated October 19, 1984, only the payroll tax was implemented. The ad hoc duty-free privileges, which had been eliminated on July 6, 1984, were reinstated in November 1984 at 50 percent of their previous level and the import surcharge was not applied. An across-the-board increase in all import duties by 10 percentage points was, however, implemented on May 1, 1985. Furthermore, the practice of financing expenditure by cancelling present and future tax liabilities has become increasingly widespread. Cash revenue foregone through the acceptance of customs drawback certificates was estimated at $8 million for FY 1984/85. The amount of excise tax on gasoline due from the Liberian Petroleum Refining Company (LPRC) in the first semester of FY 1984/85 was $10.1 million, but these revenues were not paid to the Ministry of Finance, partly because the Finance Ministry did not pay for its consumption of gasoline and electricity. While the gasoline excise tax was raised, effective March 19, 1985, from $1.25 to $1.50 per gallon, the actual revenue passed on to the Ministry has been negligible through May 1985. At the same time, foreign grant receipts are estimated to be $22 million less than envisaged in the budget.

Despite the scarcity of financial resources, total expenditures are estimated to exceed the programmed level by $43 million, reflecting extrabudgetary outlays and unallocated expenditures but also an overrun in the wage bill. Expenditure rose by 17 percent to $389 million in 1984/85. Relative to GDP, expenditure rose to 34.0 percent from 30.3 percent in 1983/84, largely undoing the reduction in expenditure achieved in 1983/84. Despite the introduction of a $10 monthly paycheck deduction on October 1, 1984, the wage bill, on a commitment basis, exceeded the budgeted level by an estimated $4 million, mainly due to the hiring of new teachers and soldiers along with delays in the implementation of the retirement and redundancy schemes. Extrabudgetary outlays, estimated at $15 million, include expenditure carryovers from the previous fiscal year of $7 million and extrabudgetary expenditures of $8 million for which duty drawback certificates have been issued. Finally, unallocated expenditures are estimated at $74 million, comprised of an estimated $26 million of payment commitments which have not yet been recorded as expenditure and a $48 million of unidentified extrabudgetary expenditures residually estimated.

Because of recent changes in accounting procedures, the Government was able, for the first time, to conduct a survey of domestic payments arrears. The level of total domestic arrears appears to have increased by $47 million in FY 1984/85, of which paycheck arrears account for about $3 million, arrears to vendors for about $26 million, and arrears to the LPRC for about $18 million, to a projected total of $92 million by June 1985. In addition, there are substantial arrears on government purchases from other public enterprises, which in turn have tax arrears to the Government and payments arrears to each other. Finally, the Government has incurred substantial arrears on its external debt service obligations.

3. Public corporations

The Government of Liberia is continuing its efforts to rationalize the public enterprises, but progress to date has been slow. These corporations continue to receive subsidies directly and indirectly from the Government and to burden the economy otherwise through inefficient operations. The Government has, however, been working closely with the World Bank on a joint project to rationalize the major public corporations, and on March 7, 1985, announced a comprehensive program of reform and restructuring. The key objectives of this program, which forms part of the conditions for the World Bank's Structural Adjustment Credit (SAC), are to reduce the size of the public enterprise sector through divestiture and/or liquidation, to restore the operational efficiency and financial health of the remaining enterprises, and to establish the institutional and policy environment for government/enterprise relations.

Specific corporations affected by the program include:

a. restructuring the LPRC from a refining company to an importing and distribution company, eliminating its monopoly on petroleum products, and rationalizing the work force to reflect this new function. With this change in functions, the LPRC is expected to reduce its work force from an estimated 450 to 180 by the end of June 1985 which, in addition to mothballing the refinery, will generate financial savings for the Government;

b. selling 50 percent of the Liberian Timber and Plywood Company to a private company which will also provide the management; and

c. terminating the operations of the National Iron Ore Company (NIOC) which has been receiving indirect subsidies from the Government, estimated at $10 million in FY 1984/85.

Other corporations targeted in this joint program with the World Bank include the Liberia Electricity Corporation, the Liberia Water and Sewer Corporation, the Telecommunications Corporation, the National Port Authority, and Air Liberia. A tentative decision has been made to privatize Air Liberia, and consideration is being given to specific offers from private companies.

4. Money and credit

Monetary and credit policies for the 1984/85 program year were designed to enhance the external position of the National Bank of Liberia (NBL) to avoid any further involuntary buildup of excess reserves by the commercial banks with the National Bank, and to assure adequate domestic credit from the banking system to the private sector. To achieve these objectives, the monetary program for 1984/85 provided for no increase in domestic assets of the National Bank, no increase in net credit to

Government from the banking system, and no increase in net credit to public enterprises from the National Bank. Ceilings consistent with these targets were set as performance criteria for end-December 1984, and end-March and end-June 1985.

In the event, data indicate that the ceilings on banking system credit to Government for end-December 1984 and for end-March 1985 were exceeded due to the rising budget deficit. Outstanding credit from the banking system to the Government is projected at $355.0 million at end-June 1985, after taking into account a recently undertaken reclassification of the NBL accounts as a result of which credit to Government increased by $41.7 million in April 1985, compared with no increase in the original program. The ceilings on net domestic assets of the National Bank were observed, partly because the accumulation of external arrears was not recorded on the balance sheet of the National Bank, and partly because the issuance of coins was not included in the definition of net domestic assets, given Liberia's monetary arrangement which, in principle, was not to rely on domestic currency creation. The ceilings on net credit to the public enterprises were also observed because these enterprises accumulated domestic arrears.

These developments occurred against a background of a pronounced shortage of liquidity and a growing compartmentalization of the financial system. Despite the accumulation of government deposits with the commercial banks during the period July-December 1984, the commercial banks were unable to provide adequate cash balances to meet monthly payroll needs in keeping with the terms of the agreement reached between the Government and the commercial banks in May 1984. 1/ These liquidity problems reflected substantial hoarding of U.S. currency by nonbank residents and the outflow of Liberian coins to neighboring countries to finance border trade.

As the shortage of cash intensified, the commercial banks became increasingly reluctant to cash or accept for deposit checks drawn on the National Bank and on other commercial banks as they feared that such actions would further deplete their cash balances and add to their existing stock of excess reserves which the National Bank was unable to convert into cash or transfer abroad. Of particular concern to the commercial banks was the long-standing issuance of Legal Power of Attorney (LPA) checks or government salary checks which were drawn on the National Bank, but pledged to commercial enterprises to discharge credit obligations incurred by the government employees. The banking system would only accept these checks at a discount estimated at 10-15 percent. The restrictions imposed by the commercial banks on their customers, and

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1/ In this agreement, the Government transferred its financial transactions to the commercial banks and the commercial banks undertook to make available up to $5 million monthly to meet the payroll, provided the Government held balances in the banks of at least an equivalent amount.

their inability to provide cash, resulted in a decline in the use of banking facilities by the public as reflected in the decline in private sector deposits. The inability of the National Bank to convert the excess reserves of the commercial banks into balances with non-resident banks and the practice of discounting checks issued by the Government are among the elements of a growing distinction between U.S. dollar notes (foreign currency) and the Liberian currency.

To help ease the liquidity crisis, the National Bank issued an estimated $9 million in Liberia coins in 1984/85. As Liberian coins in circulation rose, the private sector withdrew U.S. currency from the banking system ($6 million); thus the recorded money supply increased by only $2 million in 1984/85 (Table 6). Liberian coins in circulation now comprise 23 percent of the recorded money supply, as against 9 percent in 1980.

In a renewed attempt to increase liquidity within the financial system and to maintain the convertibility of the Liberian dollar, a new agreement was signed on May 10, 1985 between the Government and the commercial banks following the expiration of the original banking arrangement. In addition to continuing to provide the Government with U.S. currency up to a maximum of $5 million per month for balances held by the Government, the new agreement provides for the commercial banks to surrender to the Government up to 15 percent of their foreign exchange receipts (up to a maximum of $2.5 million per month) in exchange for government balances deposited with the commercial banks. This new arrangement also limits the increase in excess reserves of the commercial banks which results from the acceptance of LPA checks. Each commercial bank may open an account with the National Bank, funded by the Ministry of Finance, specifically for the purpose of providing resources to cover the LPA portion of the government payroll. The Government of Liberia has also agreed to refrain from practices that would lead to the creation of money as a means of financing the budget deficit. This means that new coins could be issued by the NBL only to the commercial banks against their excess reserves held at the NBL.

The National Bank of Liberia reduced the required reserve ratio to 22 percent from 30 percent, effective February 1, 1985, to stimulate a greater diversity in the lending operations of the commercial banks. To encourage credit to the private sector, the National Bank also instructed the commercial banks to reduce their lending rates from the prevailing rate of 25 percent to a level equivalent to the New York prime plus 4 percent with effect from March 1, 1985.

5. External developments

The erosion in confidence in Liberia's financial management was clearly evidenced in developments in the external accounts in 1984/85. The capital account is expected to be in balance as modest outflows on the official long-term account are offset by inflows in the private

Table 6. Liberia: Monetary Survey, 1980-85

(In millions of dollars; end of June)

	1980	1981	1982	1983	1984	1985 June Est.
Net foreign assets	-81.8	-89.9	-161.4	-190.7	-235.7	-301.6
National Bank of Liberia 1/	-41.2	-70.1	-121.5	-182.3	-223.6	-270.6
Of which: use of Fund credit	(-38.4)	(-62.1)	(-124.3)	(-188.0)	(-219.9)	(-193.4)
overdue repurchases to the Fund	(--)	(--)	(--)	(--)	(--)	(-15.0)
government external debt arrears	(--)	(--)	(--)	(--)	(-4.7)	(-67.3)
charges overdue to the Fund	(--)	(--)	(--)	(--)	(--)	(-10.8)
other arrears	(--)	(--)	(--)	(--)	(-4.7)	(-56.5)
Commercial banks	-40.6	-19.8	-39.9	-8.4	-12.1	-31.0
Domestic credit	242.0	218.6	294.4	342.7	416.9	454.7
Public sector (net)	91.9	142.2	215.7	274.1	342.0	384.7
Government (net)	(87.8)	(126.6)	(177.3)	(258.9)	(317.8)2/	(355.0)2/
Public corporations (net)	(4.1)	(15.6)	(38.4)	(15.2)	(24.2)	(29.7)
Private sector	150.1	76.4	78.7	68.6	74.9	70.0
Recorded money supply 3/	112.4	95.4	105.2	114.1	124.2	123.0
Coins in circulation	10.3	11.3	11.9	16.0	19.4	28.0
Deposits 4/	102.1	84.1	93.3	98.1	104.8	95.0
Demand deposits	(48.3)	(40.7)	(41.3)	(41.3)	(52.0)	(...)
Time deposits	(18.8)	(11.2)	(14.6)	(17.0)	(16.0)	(...)
Savings deposits	(35.0)	(32.2)	(37.4)	(39.8)	(36.8)	(...)
Other items (net) 5/	47.8	33.3	26.9	37.9	57.0	30.1

Sources: Data provided by the Liberian authorities; and staff projections.

1/ Foreign liabilities of the National Bank of Liberia adjusted to include external arrears of the Government, with effect from June 1984.

2/ A reclassification of the NBL accounts in April 1985 resulted in an adjustment of credit to Government of $17.8 million in June 1984 and $41.7 million in June 1985.

3/ The recorded money supply excludes U.S. notes in circulation. No data are available in the amount of these notes. Estimates vary from $30 million to $70 million.

4/ Data for June 1981 and June 1982 are not strictly comparable with data for later years because of a reclassification of claims and deposits of Government, public corporations, and private sector with the National Housing and Savings Bank.

5/ Other items (net) include the offsetting item of the adjustments to foreign liabilities of the National Bank, with effect from June 1984. These adjustments involve primarily the inclusion of an offsetting account to Government's external debt arrears in the net foreign liabilities.

sector account. The 1984/85 current account deficit and the capital outflows are expected to be financed by a substantial accumulation of external arrears, equivalent to about 7 percent of GDP.

The current account deficit for 1984/85 is estimated at US$68 million or 5.9 percent of GDP (Table 7). This estimated deficit is somewhat lower than the current account deficit of US$79 million envisaged in the program, due to a higher-than-anticipated trade account surplus. The trade account surplus amounted to $66 million in 1984/85, despite a large shortfall in export earnings, because import payments fell short by an even larger amount due to the lower-than-expected availability of import financing. The improved trade balance is expected to be partially offset by smaller official transfers associated with diminished grants for budget support.

The capital account is projected to be in balance in 1984/85, even after accounting for debt relief of $36 million. The estimated net outflow of official long-term capital would constitute a significant departure from past trends; the projected small outflow on the private account represents a continuation of past trends. Disbursements of official long-term capital are estimated to have declined because of the inability of the Government of Liberia to finance the local costs of development projects and the curtailment of disbursement by certain foreign creditors as external arrears to those creditors were accumulated. Turning to the private sector, domestic commercial banks repatriated virtually all of their remaining overseas assets, while the nonbank private sector withdrew U.S. currency from the domestic banking system, resulting in negative entry in errors and omissions.

These developments in the current and capital accounts produced an overall deficit of $58 million in 1984/85, or 5.2 percent of GDP, compared with a program target of overall balance. This deficit and a small increase in foreign assets ($2 million) is estimated to have been totally financed by an accumulation of external arrears of $76 million, including arrears to the Fund.

External debt is estimated to have increased by 10 percent in 1984/85 to $1,032 million, of which $82 million would be external arrears. Use of Fund credit constituted 22 percent of the medium- and long-term external debt. External debt was equivalent to 232 percent of exports of goods and services, which is average for countries in sub-Saharan Africa. Debt service payments before debt relief and including the Fund were $149 million in 1984/85 or 34 percent of exports of goods and services. Debt relief reduced the debt service ratio for rescheduled payments to 25 percent, which also is about average for countries in sub-Saharan Africa.

A rescheduling of public and publicly guaranteed external debt by official creditors was undertaken in 1984/85 under the auspices of the Paris Club. Bilateral creditors agreed to provide debt relief to Liberia on December 17, 1984 (see SM/85/19, January 23, 1985). The budgetary

Table 7. Liberia: Balance of Payments, 1980/81-1985/86

	1980/81	1981/82	1982/83	1983/84	1984/85		1985/86
	Estimates				Program	Revised estimates	Projected
	(In millions of U.S. dollars)						
Current account	-107	-75	-88	-61	-79	-68	-69
Trade balance	33	35	27	45	26	67	64
Exports, f.o.b.	(555)	(509)	(452)	(436)	(477)	(432)	(436)
Imports, c.i.f.	(-522)	(-474)	(-425)	(-391)	(-451)	(-366)	(-376)
Services (net)	-163	-172	-171	-162	-169	-169	-177
Of which: interest on public debt	(-29)	(-41)	(-51)	(-54)	(-59)	(-61)	(-63)
Transfers (net)	23	62	56	56	64	37	48
Private	(-34)	(-36)	(-36)	(-36)	(--)	(-38)	(-38)
Public	(57)	(98)	(92)	(92)	(--)	(75)	(86)
Capital	56	23	15	25	79	--	4
Official long-term	51	25	16	11	22	-9	26
Drawings	(69)	(52)	(51)	(51)	(82)	(55)	(91)
Amortization	(-18)	(-27)	(-35)	(-40)	(-60)	(-64)	(-65)
Private (net)	-7	-27	-27	-20	20	-27	-22
Commerical banks	(-21)	(18)	(-29)	(4)	(...)	(19)	(--)
Nonbank (including errors and omissions)	(14)	(-45)	(2)	(-24)	(...)	(-46)	(-22)
Debt relief	12	25	26	34	37	36	...
Interest	(4)	(5)	(4)	(7)	(5)	(6)	(...)
Amortizations	(8)	(20)	(22)	(27)	(32)	(30)	(...)
SDR allocation	5	--	--	--	--	--	--
Valuation adjustment	--	9	5	3	--	10	--
Overall balance	-46	-43	-68	-33	--	-58	-65
Financing	46	43	68	33	--	-58	-44 1/
National Bank of Liberia	36	51	56	42	--	-18 2/	-44 1/
Assets (increase -)	(11)	(-1)	(2)	(3)	(--)	(-2)	(--)
Liabilities	(25)	(52)	(54)	(39)	(--)	(-16)2/	(-44)1/
Use of Fund credit (net)	(31)	(62)	(60)	(37)	(...)	(-16)2/	(-44)1/
Other	(-6)	(-10)	(-6)	(2)	(--)	(--)	(--)
Arrears (minus sign indicates reduction)	10	-8	12 3/	-9 3/	--	76 4/	--
Gap	--	--	--	--	--	--	109
Memorandum items:							
Stock of external arrears	10	2	14	5	--	80	...
	(In percent of GDP)						
Current account	-9.8	-6.7	-8.2	-5.6	-6.9	-5.9	-5.7
Debt relief	1.1	2.2	2.4	3.1	3.2	3.1	...
Overall balance	-4.2	-3.8	-6.4	-3.0	--	-5.2	5.4

Sources: Data provided by the Liberian authorities; and staff estimates.

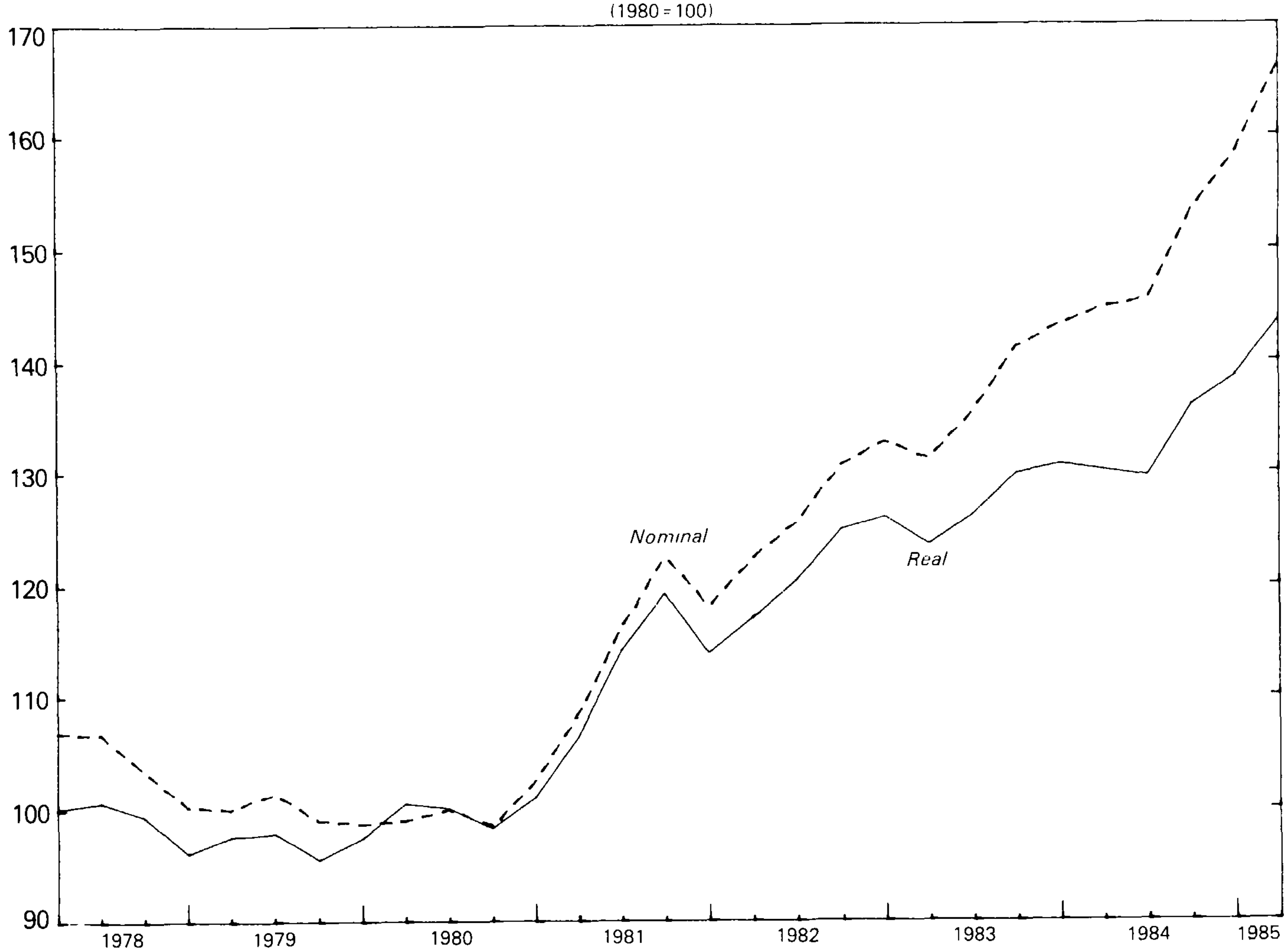
1/ Scheduled repurchases; assumes no purchases.
2/ Scheduled repurchases of which SDR 1 million were actually made.
3/ Excludes $26 million debt incurred to the oil facility banks.
4/ Includes arrears to the Fund of US$28 million.

CHART

LIBERIA

NOMINAL AND REAL EFFECTIVE EXCHANGE RATES, TRADE WEIGHTED INDICES, 1978-85

(1980 = 100)



Source: IMF, Data Fund

and balance of payments relief obtained during 1984/85 from this agreement amounted to an estimated $17 million. As part of the Agreed Minutes, an account was established into which payments would be made by the Government of Liberia for debt service payments to Paris Club creditors. While the required payments have been made into this account, the Government of Liberia has nevertheless fallen into arrears on earlier Paris Club agreements and has not fully cleared the outstanding arrears associated with the recent Paris Club agreement.

Commercial banks also agreed in principle in December 1984 to refinance 95 percent of the principal payments falling due in 1983/84 and 1984/85. The new loans had a maturity of 6 years with a grace period of 2 years; the spread was 1 3/4 percent above LIBOR. The group of banks in the oil financing facility also agreed to refinance the $26 million outstanding under that facility on the same terms and conditions as the other banks. The total debt relief from commercial banks for 1984/85 is estimated at $16 million. These agreements have not been signed, however, because the Government of Liberia was not able to make the initial payment. Subsequently, the Liberian authorities requested that the commercial banks refinance 100 percent of the principal payments due in 1984/85, which would provide additional debt relief of $4 million. The Advisory Committee has given its informal agreement, but further progress has been held in suspension because of the accumulation of interest arrears to these bank creditors. The Liberian authorities have also requested the commercial banks to reschedule a loan of $15 million provided to the National Iron Ore Company (NIOC) which was not originally included in the London Club agreement.

The Liberian dollar, which is at par with the U.S. dollar, has appreciated substantially in nominal and real effective terms over the last six years (Chart). The nominal effective exchange rate appreciated by 43 percent from June 1979 to June 1984, while in real effective terms the Liberian currency appreciated by 32 percent over this same period. From June 1984 to March 1985, the Liberian dollar appreciated further, rising by 15 percent in nominal terms and 10 percent in real terms. The substantial real appreciation since June 1979 of the Liberian currency has severely weakened profitability in the tradable goods sector. In addition, the export sector has come under pressure because of the recession in world markets for Liberia's export commodities. The volume of exports has stagnated since 1980 and no new export products have been developed over the past six years. The export base remains extremely narrow with the three commodities, iron ore, rubber, and timber, accounting for 85 percent of export earnings.

Inasmuch as an independent exchange rate policy is precluded in Liberia by its present monetary arrangement, the external competitiveness of the tradable goods sector can only be achieved through increased productivity and compression of domestic costs, especially wages. Cost savings of the magnitude required to offset the impact of the currency appreciation on profits have been difficult to obtain solely by reducing unit labor cots. Apart from its indirect effects on the fiscal position, the real currency appreciation has also created direct budgetary problems because the Government has found it necessary to provide tax reduction and exemptions to various industries.

IV. Report on the Discussions

The mission devoted the major share of its time to the discussion of the budgetary developments, measures to close the financing gaps for FY 1984/85 and FY 1985/86, and means of ensuring prompt payment of overdue obligations, including those owed to the Fund. Given the uncertainty about policies and financing for FY 1985/86, there was little scope for discussion of the medium-term outlook.

1. FY 1985/86 pro forma budget

The Liberian authorities had completed, prior to the arrival of the May mission, a pro forma budget for FY 1985/86, but the budget was significantly revised on the basis of the consultation discussions. This revised pro forma budget, noted in Table 5, includes an overall deficit of $95 million (equivalent to 7.8 percent of GDP), a reduction in arrears of $35 million, and a financing gap of $164 million. Revenues are projected at $225 million, an increase of 17 percent, or 2.5 percent of GDP, over FY 1984/85, but virtually the same absolute level as in FY 1983/84. Some of the assumptions underlying the budget on the revenue side include:

- full enforcement of the across-the-board increase in all import duties by 10 percentage points which was implemented on May 1, 1985 (a measure expected to generate $15 million on an annual basis); and

- full collection and transfer by the LPRC to the Government of the gasoline tax ($1.50 per gallon), which is estimated at $27 million on an annual basis.

Total expenditures are budgeted to decline by 9 percent or 5 percent of GDP, despite a steep increase in the development budget and a further growth in interest payments. This decline is to be achieved by a sizable reduction in the wage bill, a large drop in other recurrent expenditure, and elimination of extrabudgetary and unallocated expenditure. Moreover, the authorities have indicated that the practice of financing extrabudgetary expenditures by the issuance of duty drawback certificates will be discontinued and they plan an orderly reduction in the level of outstanding drawback certificates (currently estimated at approximately $3-5 million) through budgetary provisions.

The wage bill is budgeted at $117 million, compared with $125 million in 1984/85. This reduction of about 7 percent is to be achieved through:

- a limitation of allocations for the ministries and agencies to the budgeted amount;

- an acceleration of the retirement scheme and an immediate and sustained implementation of the redundancy scheme; and

- the ongoing exercise of identifying and deleting "ghosts" from the payroll.

Locally-financed development expenditure is budgeted at $41 million, reflecting $31 million in local counterparts of foreign-financed projects and $10 million in purely locally-financed projects. The foreign-financed share of the development budget is projected at $60 million.

The combined total of other recurrent, extrabudgetary, and unallocated expenditure is expected to fall from an estimated $131 million in 1984/85 to $59 million in 1985/86. This includes a provision for expenditures of $10 million in connection with the election and the inauguration of the new President.

A financing gap of $164 million remains after allowing for $60 million in project loans, $15 million in PL-480 receipts, and $16 million from the SAC, but does not include the counterpart to any purchase from the Fund or debt relief from the Paris Club and the London Club, which the authorities estimated at a possible $45 million. The budget assumes, however, a reduction in external and domestic expenditure arrears of $35 million, a redemption of savings bonds of $6 million, and a reduction in the commercial banks' excess reserves with the NBL by $10 million.

The mission noted that the pro forma budget assumes a significant revenue effort and substantially improved expenditure control by the authorities. Given the authorities' performance under the current and previous Fund-supported programs in these respects in the face of similar commitments, and the fact that 1985 is an election year, the staff expressed some doubts as to whether the budget targets are credible. In particular, the staff expressed concern: (1) that the transfer of the gasoline tax revenue to Government may prove to be over-optimistic; (2) that the envisaged sharp reduction in the number of public employees appears unlikely to be accomplished in an election year; (3) that the drastic cut in the combined total of other recurrent and extrabudgetary expenditure may not be feasible; and (4) that the $10 million of locally-financed projects in the development budget were of doubtful investment quality. Moreover, the staff had some doubts as to whether such a cut in expenditure on goods and services is desirable as it is likely to result in an inappropriate balance between expenditures on goods and services and development expenditure, along with a further accumulation of expenditure arrears.

The Liberian representatives indicated that they planned to act in several areas to strengthen fiscal discipline. First, to assist in maintaining fiscal performance, they would establish realistic monthly revenue targets, any shortfalls from which would trigger fully offsetting cuts in budgetary allocations. Secondly, procedures to record all expenditures at a commitment level are being initiated in July 1985. To assist in this effort, the authorities have requested technical assistance from the FAD, and a mission has been scheduled for July 1985.

The mission suggested that, even with this significant effort, the overall deficit and the financing gap were at unfinanceable and unsustainable levels and that the expenditure program was unbalanced. The mission indicated that extraordinary measures, supported at the highest political level, would have to be taken to reduce the overall fiscal deficit and the financing gap. Foreign financial assistance would be required to help close the external financing gap, but the process of restoring credibility and financial discipline must begin with the Liberian authorities.

2. Monetary and credit policies

The Liberian representatives expressed their concern about the shortage of liquidity in the economy and the accumulation of external arrears. These developments, they indicated, resulted from the deterioration in the Government's financial situation, particularly the shortfall in revenues. To ease the domestic liquidity shortage in the economy, the authorities had taken several measures. The first measure was the issuance of $8 million in $5 coins during December 1984. While temporarily improving the liquidity situation, this action circumvented to a considerable extent the automatic stabilizer inherent in the specie flow mechanism that once characterized the Liberian monetary arrangement.

Second, the Liberian representatives explained that the objectives of the new arrangement signed in May 1985 with the commercial banks were to obtain more cash and more foreign exchange to assist in servicing the external debt. The new feature of the agreement proposed by the Government was that the banks surrender to the NBL up to 15 percent of their export receipts. (Depending upon the definition of export receipts, this could amount to $3-4 million per month but the Government agreed to a limit of $2.5 million per month.)

The mission agreed that the banking arrangement had been a useful measure to encourage financial discipline on the part of the Government during most of 1984 and therefore should be continued. As for the foreign exchange surrender requirements, the mission expressed no objections, but pointed out that this additional provision would only be helpful if the Government generated adequate local deposits to convert abroad. The mission encouraged the Liberian representatives not to lose sight of this vital objective.

A third measure was the reduction in commercial bank loan rates. The representatives explained that, as international interest rates had risen, the banks had raised their loan rates to 25 percent, the ceiling imposed by the usury law, but the banks had not followed the more recent downward trend of international rates. The NBL decided, therefore, to issue a directive to the banks, effective March 1, 1985, to reduce lending rates from 25 percent to a level equivalent to the New York prime rates plus 4 percent. (Deposit rates are 8.1 percent and 9.9 percent for savings and time deposits, respectively.) The mission noted that lending rates were high relative to international rates because the risk of loss was greater in Liberia. The legal structure, for example, made it impossible for banks to foreclose in the event of bad loans. The Liberian representatives acknowledged the need for addressing the latter problem and indicated that they had approached the Minister of Justice with suggestions for resolving it. The mission also pointed out that the high level of required reserves and involuntary excess reserves, which was about 50 percent of deposits, necessitated a large spread between lending and deposit rates. The representatives said they had reduced reserve requirements to alleviate this problem, but it had not affected the level of required and excess reserves.

3. External outlook, 1985/86

The Liberian authorities acknowledged that pressure on the external accounts would intensify in 1985/86, in line with the continued large fiscal deficit and the increase in debt service payments, especially to the Fund. The current account deficit is projected to remain virtually unchanged as anticipated greater official transfers offset an expected decline in the trade surplus and somewhat higher net service payments. The capital account is expected to swing into a small surplus as drawings on official loans increase and nonbank private outflows diminish. The increased disbursements of official loans is predicated on drawings of project loans of $60 million, commodity assistance of $15 million, and a World Bank structural adjustment credit of $16 million. These flows, however, are threatened by the high level and continuing accumulation of external arrears. The overall deficit is projected at $65 million. Financing for this deficit and for the scheduled repurchases to the Fund of $44 million has not yet been identified. Thus an unfinanced gap of $109 million, or 9 percent of GDP, is envisaged for 1985/86.

The Liberian authorities expressed the view that the major external issues confronting the Liberian economy were the ex ante financing gap projected for 1985/86 and the orderly payment of existing external arrears. In the absence of an independent exchange rate policy, the authorities have been limited to fiscal measures to close the external financing gap. Specific measures proposed by the authorities to help fill the external financing gap included the following: (1) new debt relief from the Paris Club ($21 million); (2) refinancing 100 percent of the amortization payments falling due to commercial banks ($24 million); (3) surrender by commercial banks of 15 percent of their offshore receipts for government deposits ($30 million); and (4) the allocation of 60 percent of the offshore revenues of the Government of Liberia from maritime fees, royalties, and offshore payment of taxes by concessions ($36 million) for payment of debt service obligations. These measures would close the external financing gap. The mission therefore expressed the view that the external payments difficulties would then stem primarily from the budget deficit and not from an inadequacy of foreign exchange receipts. In that event, foreign exchange receipts would be adequate to cover debt service payments so long as the Government did not divert these foreign resources to other uses.

The Government of Liberia recognized the damage to its creditworthiness caused by external arrears. In an effort to contain that damage, the Government was considering procedures in the National Bank of Liberia to monitor the level of arrears by creditor, by interest or principal, and by age. This information would provide necessary input into the decision-making process for orderly payment of arrears. Guidelines were also being developed for allocating scarce foreign exchange to open a special account for the payment of debt service obligations, including external arrears. The Government has requested technical assistance from the Fund's Central Banking Department in developing procedures to monitor its external arrears.

The magnitude of the domestic and external imbalances confronting the Liberian economy in 1985/86 clearly imply that present domestic policies are unsustainable over the medium term. Indeed, as already indicated, major uncertainties exist concerning the future course of domestic policies, external arrears, and external debt. These uncertainties will remain until a policy strategy and financing package are developed to close the large ex ante financing gap. With such major imbalances and uncertainties concerning domestic policies, a meaningful medium-term scenario could not be produced as the range of possible assumptions and outcomes is exceptionally wide. It is nevertheless clear that present policies are not viable and that the financing gap will be closed ex post. Whether the adjustment process which closes the financing gap is orderly or not will largely depend on the Liberian authorities.

V. Staff Appraisal and Proposed Decision

The financial condition of the Liberian Government deteriorated sharply in FY 1984/85, compared both with the previous year and with the budget adopted for 1984/85. A shortfall in revenues coupled with the emergence of large extrabudgetary expenditures resulted in a significant worsening in the budget deficit and an accumulation of arrears. The FY 1984/85 budget called for an increase in revenues of $21 million, or 9 percent, on the basis of strengthened revenue collections, a recovery in the economy, and new tax measures yielding $11 million. In the event, revenues declined by an estimated $32 million, in part because the Government, contrary to its stated intentions, failed to implement some of the new tax measures and in fact reduced others; the staff views these developments with the utmost concern. The recent revisions in the balance sheet of the NBL have added to these concerns. Further, the economy did not recover as rapidly as expected, and tax collection efforts were not successful in the face of political and economic uncertainties. As cash financing (domestic and foreign) only covered $89 million of the overall deficit of $174 million (on a commitment basis), expenditure arrears of $85 million were accumulated during the year. External arrears are estimated to rise to $80 million by end-June 1985.

Liberia is at a critical turning point. Decisive and immediate action is required to deal with the major and worsening imbalances in the economy. In the absence of decisive adjustment policies, external and domestic arrears will continue to accumulate and the domestic financial structure would weaken and fragment under liquidity pressures. The staff believes that urgent and extraordinary actions on the part of the Government of Liberia need to be implemented if Liberia's monetary arrangement is to be preserved. The staff urges the Liberian authorities to move expeditiously in improving fiscal discipline and in timely servicing of external debt. For this purpose, additional fiscal measures beyond those already proposed by the authorities for FY 1985/86 would be needed to cope with the financial imbalances and reduce the fiscal deficit to a sustainable level. The staff also urges the authorities to give utmost priority to the adoption of measures that would facilitate prompt payment of the arrears to the Fund and help to restore creditors' confidence in Liberia's policies. Fiscal discipline and timely debt service are essential to restore creditor confidence and the latter is essential to ensure continued external financial support.

The medium-term outlook for Liberia will depend largely upon the effectiveness and credibility of the actions that must be taken by the Government of Liberia to resolve the current financial crisis. If strong and lasting measures can be taken, the prospects for growth with price stability are favorable. Moreover, the World Bank is intensifying its efforts in Liberia. The Bank recently negotiated a SAC of $32 million, which was designed to overlap with, and to supplement, the now inoperative Fund stand-by arrangement. In addition, to support the efforts toward fiscal discipline, the Bank is focusing on rationalizing the public enterprises. The most significant action in this area, when completed, would be the restructuring of the LPRC from a refining company to an importing and distribution company, the elimination of its monopoly on petroleum products, and the rationalization of the work force to reflect the new function.

A long-standing fundamental issue in the case of Liberia is its monetary arrangement under which the Liberian currency is pegged at par to the U.S. dollar. For the past two years the Fund staff has been concerned about the impact of the substantial real appreciation of Liberia's currency on the performance of the economy. The significant erosion in external competitiveness in recent years has compounded the difficult fiscal situation and has adversely affected the growth of real GDP.

The appropriateness of the U.S. dollar as the circulating currency has been studied and debated for several years and no definitive conclusions have emerged. For years, this arrangement has been characterized as akin to the gold standard adjustment mechanism under which financial discipline was automatically assured. Excess credit expansion to finance large budgetary deficits would result in balance of payments deficits and declines in the money supply that would produce the needed adjustment in the economy. The Government has, however, offset a contraction in money supply by issuing domestic currency and by accumulating arrears. The staff has discussed with the authorities the de facto change in the operation of their monetary system and indicated the need to re-establish financial discipline.

With regard to external payments arrears owed by public sector enterprises, the following is the staff's understanding of the general situation. Public enterprises, especially the public utilities, would appear to rely on repayment of the outstanding bills that the Government owes them in order to be able to repay their own external arrears. The Government itself does not have the resources to pay its own internal obligations without recourse to borrowing from the NBL (which is capable of lending to the Government).

The Government when pressed for payment by these enterprises makes out a payment order addressed to the NBL authorizing the latter to debit the Government's account with the NBL and to then effect the necessary external payment on behalf of the relevant enterprise. It would appear, however, that, owing to the Government's lack of own financial resources, these payment orders are neither honored in full nor in a timely manner, thereby giving rise to more delays in making payments on the underlying external payments arrears. Priority for the allocation of the NBL's scarce foreign exchange then results as some payments are made now while others have to be postponed until receipt of future available foreign exchange. Such a priority scheme, prima facie, would appear to give rise to restrictions on payments and transfers for current international transactions in those cases in which governments or exchange control authorities regulate foreign payments or the availability of foreign exchange.

Liberia maintains an open economy with the surrender of foreign exchange limited only to commercial bank receipts of foreign exchange as already described. The authorities have not imposed any further restrictions. While there may have been action by the authorities, it is not clear whether and to what extent there exists any specific regularization of the arrears that would substantiate a governmental limitation on the use or availability of foreign exchange. The staff will keep monitoring the situation closely for further evidence in order to enable a more definitive analysis of Liberia's external payments arrears and the exchange system.

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

The following draft decision is proposed for adoption by the Executive Board:

1. The Fund takes this decision in concluding the 1985 Article XIV consultation with Liberia, in the light of the 1985 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/85/ , which may give rise to such restrictions. The Fund urges the authorities to eliminate these payments arrears as soon as possible.

Liberia - Relations with the Fund
(As of May 31, 1985)

I. Membership status

a. Date of membership: March 28, 1962
b. Status: Article XIV

A. Financial Relations

II. General Department (General Resources Account) SDR 71.3 million

	SDR million	Percent of quota
a. Quota:		
b. Fund holdings of Liberian dollars	282.45	396.1
c. Fund holdings subject to repurchase and charges:	211.15	296.1
credit tranches	51.64	72.4
supplementary financing facility	39.10	54.8
enlarged access resources	84.28	118.2
compensatory financing facility	36.13	50.7

d. Reserve tranche position: SDR 9,550

III. Current stand-by arrangement and special facilities

a. Current stand-by arrangement:

i. Duration	From December 7, 1984 to June 6, 1986
ii. Amount	SDR 42.78 million
iii. Utilization	SDR 8.50 million
iv. Undrawn balance	SDR 34.28 million

b. *Stand-by arrangements during the last ten years:*

Arrangements	Duration	Amount	Utilization (In millions of SDRs)	Undrawn Balance
Stand-by	8/14/74-8/13/75	4.0	--	4.0
Stand-by	1/14/76-1/13/77	5.0	--	5.0
Stand-by	3/21/79-3/20/80	9.25	9.25	--
Stand-by	9/15/80-8/25/81	65.0	32.0	33.0
Stand-by	8/26/81-8/25/82	55.0	55.0	--
Stand-by	9/29/82-9/13/83	55.0	35.0	20.0
Stand-by	9/14/83-9/13/84	55.0	55.0	--

c. Special facilities:

Compensatory financing facility	8/18/82	SDR 7.0 million
Compensatory financing facility	9/29/82	SDR 12.7 million

IV. SDR Department

a. Net cumulative allocation:	SDR 21.01 million
b. Holdings:	--

V. Administered accounts

a. Trust Fund loans:

i. Disbursed	SDR 28.34 million
ii. Outstanding	SDR 24.97 million

b. SFF subsidy account:

i. Donations to Fund	--
ii. Loans to Fund	--
iii. Payments by Fund	SDR 3.93 million

VI. Overdue obligations to the Fund — SDR 24.4 million (as of 5/30/85)

B. Nonfinancial Relations

VII. Exchange rate arrangement

The Liberian dollar is pegged to the U.S. dollar at the rate of Lib$1.00 = US$1.00.

VIII. Article IV consultation

The 1983 Article IV consultation discussions with Liberia were held in Monrovia during the period December 5-18, 1983. The staff report (EBS/84/54, 3/12/84) was discussed by the Executive Board on April 6, 1984, and the decision was:

1. The Fund takes this decision in concluding the 1983 Article XIV consultation with Liberia, in the light of the 1983 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 with satisfaction that Liberia continues to maintain an exchange system that is free of restrictions on payments and transfers for current international transactions.

Consultation discussions with Liberia are on an annual basis.

IX. Technical assistance

The Central Banking Department is providing three experts to the National Bank of Liberia to fill the posts, respectively, of General Manager, advisor in the research/statistical field, and advisor in the area of bank supervision. In addition, CBD is providing to the Ministry of Finance a consultant on external debt.

X. Resident Representative

A Fund resident representative has been assigned to Monrovia since January 1981.

Liberia - Overdue Obligations to the Fund

(May 31, 1985)

Type of obligation	Date of purchase or loan	Due date	Days overdue	SDR amount
General Department				
CF repurchase	12/20/79	12/19/84	152	1,433,587
CT repurchase	9/25/81	12/21/84	150	625,000
CT repurchase	10/02/80	12/28/84	143	478,674
CT repurchase	4/08/81	1/07/85	133	386,364
Semi-annual charges		1/15/85	125	6,964,564
CT repurchase	2/04/81	2/01/85	108	386,364
CT repurchase	2/04/81	2/01/85	108	463,636
Quarterly charges		2/06/85	103	1,541,144
CT repurchase	8/31/81	2/28/85	81	1,259,909
CT repurchase	8/31/81	2/28/85	81	115,091
CT repurchase	12/16/81	3/14/85	67	625,000
CT repurchase	12/17/80	3/14/85	67	386,364
CT repurchase	9/25/81	3/22/85	59	625,000
CT repurchase	9/25/81	3/22/85	59	750,000
CT repurchase	10/02/80	4/01/85	49	478,674
CT repurchase	10/02/80	4/01/85	49	971,326
CT repurchase	4/08/81	4/05/85	45	386,364
CT repurchase	4/08/81	4/05/85	45	463,636
CT repurchase	2/04/81	5/03/85	17	386,384
Quarterly charges		5/06/85	14	1,509,823
CT repurchase	8/31/81	5/30/85	--	1,259,909
Subtotal				21,496,813
SDR Department				
Net SDR charges		2/01/85	108	426,465
Assessment		4/30/85	20	3,528
Net SDR charges		5/01/85	19	441,700
Subtotal				871,693
Trust Fund				
Repayment	1/26/78	1/25/85	115	191,400
Repayment	1/27/77	1/25/85	115	153,700
Repayment	7/27/78	1/25/85	115	700,276
Repayment	7/31/79	1/30/85	110	687,300
Repayment	8/04/77	2/04/85	105	156,600
Repayment	10/31/79	4/30/85	20	191,400
Subtotal				2,080,676
Total				24,449,182

Liberia - Relations with the World Bank Group

(As of February 28, 1985; in millions of U.S. dollars)

	Total	Disbursed	Undisbursed
IBRD	155.95	130.85	25.10
Agriculture	19.00	2.43	16.57
Rubber	(7.00)	(0.06)	(6.94)
Oil palm	(12.00)	(2.37)	(9.63)
Transportation	62.85	56.51	6.34
Highways	(48.55)	(48.55)	(--)
Feeder roads	(10.70)	(4.36)	(6.34)
Port of Monrovia	(3.60)	(3.60)	(--)
Energy	31.80	31.64	0.16
LEC	(26.80)	(26.80)	(--)
Petroleum exploration	(5.00)	(4.84)	(0.16)
Mining: iron ore	20.00	18.17	1.83
Education	10.30	10.30	--
Development finance	12.00	11.80	0.20
IDA	106.90	65.56	41.34
Agriculture	48.40	31.80	16.60
Rubber	(6.00)	(5.99)	(0.01)
Forestry	(6.00)	(3.86)	(2.14)
Agricultural development	(36.40)	(21.95)	(14.45)
Transportation: highways	15.80	5.85	9.95
Education	20.70	14.07	6.63
Urban development	10.00	4.68	5.32
Water supply	8.00	8.00	--
Small- and medium-scale enterprises	4.00	1.16	2.84
Total	262.85	196.41	66.44
Of which: agriculture	(67.40)	(34.23)	(33.17)
transportation	(78.65)	(62.36)	(16.29)
education	(31.00)	(24.37)	(6.63)
Repayments	25.91		
IBRD	25.66		
IDA	0.25		
Total outstanding (including undisbursed)	236.94		

IFC Investments: equity held: 0.55

Source: IBRD.

LIBERIA - Basic Data

Area, population, and GDP per capita

Area	111,370 square kilometers
Population: Total (1982)	2.06 million
Growth rate	3.4 percent
GDP per capita (1982)	$540 (SDR 490)

	1980/81	1981/82	1982/83	1983/84	1984/85 Estimate
GDP at constant 1971 prices			(In millions of dollars)		
Agriculture	56.2	55.0	50.1	50.6	52.6
Of which: rubber	(21.1)	(21.6)	(21.4)	(21.1)	(21.8)
Mining and quarrying	111.3	114.4	86.2	84.4	83.6
Of which: iron ore	(106.0)	(107.9)	(80.2)	(78.4)	(77.6)
Other monetary economy	236.3	228.5	220.7	223.1	228.6
Manufacturing	(24.8)	(22.4)	(21.4)	(...)	(...)
Construction	(14.5)	(13.5)	(12.9)	(...)	(...)
Government services	(41.5)	(42.9)	(42.0)	(42.0)	(42.0)
Other services	(155.5)	(149.7)	(144.4)	(...)	(...)
Total monetary economy	403.8	397.9	357.0	358.1	364.8
Subsistence economy	81.2	83.7	85.8	88.9	92.5
Total GDP	485.0	481.6	442.8	447.0	457.3
GDP at current market prices	1,094.7	1,121.9	1,066.7	1,094.0	1,145.0
Annual rates of growth of GDP and prices			(In per cent)		
GDP at constant prices	-3.4	-0.7	-8.1	0.9	2.3
GDP at current prices	0.2	2.5	-4.9	2.6	4.7
GDP deflator	3.6	3.2	3.0	1.7	2.3
Consumer price index	10.0	7.0	4.7	1.6	2.5
Central government finance			(In millions of dollars)		
Revenue and grants	242	279	257	260	215
Revenue	217	238	224	224	192
Grants	24	41	33	36	23
Expenditure	375	370	390	332	389
Recurrent	236	287	261	237	238
Development	124	96	96	73	62
Nonbudgetary	7	-13	33	22	89

LIBERIA - Basic Data (continued)

	1980/81	1981/82	1982/83	1983/84	1984/85 Estimate
			(In millions of dollars)		
Overall balance 1/	-133	-91	-132	-72	-174
Expenditure arrears	7	-6	8	-7	85
Overall deficit: cash basis	-126	-97	-125	-79	-89
Financing	126	97	125	79	85
Foreign (net)	65	42	43	38	52
Drawings	(67)	(46)	(44)	(45)	(57)
Amortization	(-16)	(-29)	(-29)	(-40)	(-38)
Debt relief	(14)	(25)	(28)	(33)	(33)
Domestic	61	55	82	41	37
Banking system	(39)	(51)	(82)	(41) 2/	(37) 3/
Other	(22)	(4)	(--)	(--)	(--)
Money and credit					
Foreign assets (net)	-89.9	-161.4	-190.7	-235.7	-301.6
Domestic credit	218.6	294.4	342.7	416.9 3/	454.7 3/
Claims on Government (net)	126.6	177.3	258.9	317.8 3/	355.0 3/
Claims on public corporations	15.6	38.4	15.2	24.2	29.7
Claims on private sector	76.4	78.7	68.6	74.9	70.0
Recorded money supply	95.4	105.2	114.1	124.2	123.0
			(Annual rate of change)		
Domestic credit	-9.7	34.7	16.4	16.5 2/	9.1 3/
Claims on Government (net)	44.2	40.0	46.0	15.9 2/	11.7 3/
Claims on public corporations (net)	280.5	146.2	-60.4	59.2	22.7
Claims on private sector	-49.1	3.0	-12.8	9.2	-6.5
Recorded money supply	-15.1	10.3	8.5	8.7	-1.0
Balance of payments			(In millions of dollars)		
Trade balance	33	35	27	45	66
Exports, f.o.b.	(555)	(509)	(452)	(436)	(432)
Imports, c.i.f.	(-522)	(-474)	(-425)	(-391)	(-366)
Services (net) 3/	-163	-172	(-171)	-162	-169
Transfers (net)	23	62	56	56	37
Current account balance 3/	-107	-75	-88	-61	-66
Capital (net) 3/	56	23	15	25	-4
Allocation of SDRs	5	--	--	--	--
Overall balance 3/	-46	-43	-68	-33	-58

1/ Up until 1984/85 this is a mixture of a checks-issued and a commitment basis. Since 1984/85 it is on a commitment basis.
2/ Not taking into account revision of credit figures.
3/ Including upward adjustments of $17.8 million and $41.7 million in June 1984 and June 1985, respectively, due to reclassification of some government accounts with the NBL.

LIBERIA - Basic Data (concluded)

	1980/81	1981/82	1982/83	1983/84	1984/85 Estimate
			(In millions of dollars)		
Gross official reserves (end of period)	9	9	8	5	2
External public debt					
Disbursed and outstanding (end of period) 1/	622	720	853	922	997 3/
Debt service 1/2/	38	43	62	78	113
Interest	(25)	(34)	(47)	(47)	(53)
Amortization	(13)	(9)	(15)	(31)	(60)
Debt service 1/ (in percent of exports of goods and services)	6.7	8.2	13.4	17.3	25.3

1/ Including use of Fund credit.
2/ After debt relief.
3/ Includes $26 million oil facility loan assumed under London Club II.

LIBERIA - Statistical Issues

1. Coverage, Currentness, and Reporting of Data in IFS

		Latest Data in January 1985 IFS
Real Sector	- National Accounts	1982
	- Prices	September 1984
	- Production	n.a.
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	1982
	- Financing	1982
	- Debt	n.a.
Monetary Accounts	- Monetary Authorities	December 1983
	- Deposit Money Banks	September 1984
	- Other Financial Institutions	n.a.
External Sector	- Merchandise Trade: Values	Q^4 1983
	- Merchandise Trade: Prices	Q^4 1983
	- Balance of Payments	1983
	- International Reserves	October 1984
	- Exchange Rates	November 1984

During the past year, the reporting of data for inclusion in the IFS has been somewhat irregular, but the currentness has improved recently.

2. Outstanding Statistical Issues

Real sector

The technical assistance mission on general economic data of March 1984 suggested improvements in the methodology for compiling the import value indices. It also recommended that the authorities seek technical assistance (possibly from the ILO) for processing the results of the 1976-78 National Household Expenditure Survey.

It would be helpful if the IFS correspondent would use the cable code system to communicate the consumer price index updates regularly.

Government finance

The presentation in the 1984 GFS Yearbook will include data in the statistical and derivation tables for the consolidated Central Government through fiscal year 1983. The data cover operations of the budgetary Central Government

LIBERIA - Statistical Issues (concluded)

and one extrabudgetary unit: the External Development Fund. If data could be supplied on the operations of the local administration, the presentation could be improved.

Annual data shown in IFS are those reported in the GFS Yearbook for the consolidated Central Government and extend only through fiscal year 1982.

Monetary accounts

The report of a technical assistance mission on money and banking statistics of August 1984 will be sent to the authorities in the near future. During the mission the authorities agreed in principle to a revision of the monetary statistics, and, for the present, this has held up publication of more current data on the monetary authorities. When the mission's recommendations are implemented, data on the monetary authorities should be available with a substantially reduced time lag.

Balance of payments

Data reported for 1982 and 1983 are not complete. In particular, data on direct investment and short-term capital transactions have not been reported.