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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/112

3:00 p.m., July 24, 1985

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	J.-C. Obame, Temporary
C. H. Dallara	M. K. Bush
	G. Ercel, Temporary
	C. Flamant, Temporary
	M. B. Chatah, Temporary
	M. Sugita
	B. Goos
J. E. Ismael	
	G. W. K. Pickering, Temporary
A. Kafka	
	H. Fugmann
E. I. M. Mtei	A. Abdallah
F. L. Nebbia	
	E. M. Taha, Temporary
	J. E. Rodríguez, Temporary
J. J. Polak	
	A. V. Romuáldez
	A. A. Agah, Temporary
	A. S. Jayawardena
	T. A. Clark
	L. Tornetta, Temporary
	Yang W., Temporary

L. Van Houtven, Secretary
R. S. Franklin, Assistant

Also Present

IBRD: D. Berk, Western Africa Regional Office. African Department: A. D. Ouattara, Director; G. E. Gondwe, Deputy Director; L. M. Goreux, Deputy Director; M. W. Bell, E. L. Bornemann, E. A. Calamitsis, K. G. Dublin, C. Enweze, A. S. Linde, D. E. Syvrud. European Department: W. L. Hemphill. Exchange and Trade Relations Department: J. T. Boorman, S. Kanesa-Thasan, P. Stella. Fiscal Affairs Department: C. Schiller. IMF Institute: U Tun Wai, Deputy Director. Legal Department: J. M. Ogoola. Treasurer's Department: M. F. Melhem. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: P. E. Archibong, D. Hammann, M. A. Weitz. Assistants to Executive Directors: H. Alaoui-Abdallaoui, J. R. N. Almeida, W.-R. Bengs, J. J. Dreizzen, S. Geadah, O. Isleifsson, Z. b. Ismail, J. M. Jones, M. Lundsager, D. J. Robinson, M. Sarenac, B. D. White, K. Yao.

1. LIBERIA - 1985 ARTICLE IV CONSULTATION

The Executive Directors continued from the previous meeting (EBM/85/111, 7/24/85) their consideration of the staff report for the 1985 Article IV consultation with Liberia (SM/85/188, 6/28/85). They also had before them a report on recent economic developments in Liberia (SM/85/191, 7/8/85).

The staff representative from the African Department, responding to questions on Liberia raised at EBM/85/111, observed that no adjustment program could work in the absence of a commitment at the highest political level. In Liberia, that commitment had existed through late 1984 but not since that time; unless the Government could provide a renewed commitment to adjustment, all the concrete measures that might be recommended by the staff would not suffice to resolve the problems.

In response to those who had expressed some doubts about the viability of the Liberian program, the staff representative noted that the program approved by the Board in December 1984 had been based on the experience in Liberia in 1983/84, when the budget deficit had been reduced from 12.5 percent of GDP to 6.7 percent of GDP and when cuts had taken place in nominal wages in the public sector. It had also been based on assurances of financial support from the U.S. Government that would have been adequate to cover external debt servicing and to enable the authorities to meet performance criteria at least through end-December 1984. Those funds--equivalent to $25.5 million--had not to date been disbursed by the U.S. Government.

On the quality of performance criteria, although it was clear with hindsight that limitations on the issuance of coins should have been included in the performance criteria--and would be included in any future program--it was fair to say that past experience had not called for such inclusion, the staff representative said. Indeed, through early December 1984, very few coins had been issued; some $8 million in coins had been issued in the month of December. While accepting that domestic arrears should be included where possible in performance criteria, he noted that the determination and quantification of domestic arrears were not easy tasks, although the staff had through a strong effort achieved some success in that area in recent years.

The staff had made specific suggestions for improving revenues and containing expenditures, the staff representative noted. On the revenue side, in line with suggestions, the authorities had announced an increase in the gasoline tax that, if collected, would have provided some $26 million annually. However, only a fraction of that amount had been collected, mainly because the Liberian Petroleum Refining Company, responsible for collecting the tax, had not transmitted the amounts collected to the Minister of Finance, a fact that had accounted for a large part of the revenue shortfall in 1984. Also recommended had been a 10 percent across-the-board tax on all imports; if that tax had been collected, it would have provided $15 million annually, but the authorities had apparently made no commitment to collect those taxes. On the expenditure side, as shown in Table 5, some $19 million in extrabudgetary expenditures had occurred. If the authorities had simply adhered to the budget, such adherence would have gone a long way toward resolving the budget difficulties for 1984/85.

Responding to a question from Mr. Goos regarding the establishment of special accounts aimed at meeting priority debt service payments, the staff representative noted that two special accounts had been established in the Federal Reserve Bank of New York. The first had been organized by the Paris Club in order to ensure that resources were made available for Paris Club payments. As far as he knew, those payments--which were relatively small--had been taking place. The second account, which had been established only a few months previously at the request of the U.S. Government, was intended as a joint account into which the Government of Liberia would allocate some of its own foreign exchange resources that, together with U.S. contributions, would be allocated to priority debt service payments. As far as he understood it, only a few million dollars had passed through the account to date and had been used to pay back some amounts owed the World Bank.

The issuance by the authorities of Liberian coins--contributing to the evolution of a de facto monetary system--had been aimed at meeting liquidity requirements, as U.S. dollars had been flowing out of the country, the staff representative observed. The authorities had been forced to do something, and the commercial banks had asked that the coins be issued in order to provide some liquidity in the economy. The real question was whether it was more appropriate for the National Bank of Liberia to issue the coins directly to pay salaries or whether they should be deposited on account with the commercial banks. In his view, the latter approach was somewhat more acceptable than the former in terms of fiscal responsibility.

A number of Directors had queried the level of Liberia's arrears, which at end-June 1985 had totaled some $73 million, the staff representative recalled. Further payments had come due during July and September. Given the magnitude of the arrears, any solution to the problem would require a concerted effort by the Government of Liberia, the U.S. Government, the World Bank, the Fund, and other creditors. The Liberian authorities would need to renew their commitment to adjusting and to meeting their contractual debt service payments. That commitment had dissolved in December 1984, since which time the U.S. Government had withheld $25 million in grant aid. It was his understanding that negotiations were currently under way for the release and use of those resources. Moreover, the World Bank structural adjustment loan of $32 million would have to become part of the solution to the arrears problem, as would debt relief from the Paris and London Clubs and a stand-by arrangement with the Fund. If all those elements could be brought together within the next few months, a solution to Liberia's debt problem could be found. Also, the sooner the Liberian authorities took actions to bring their budget into equilibrium, the more susceptible the arrears problem would be to solution.

In response to those who had queried the current monetary system in Liberia, the staff representative noted that programs under stand-by arrangements over the past few years had focused mainly on fiscal adjustment. An effort had been made to maintain the existing monetary system with fiscal adjustment, despite the appreciation of the U.S. dollar; some progress had been made through mid-1984. Export industries had improved their competitive position through cost-cutting measures, but some industries--such as the rubber industry--had sought and received tax relief from the Government, a development that had aggravated the fiscal problem.

The growth in the deficit in 1984/85, despite moderate growth in the economy, raised questions whether the necessary adjustments could be achieved in future through fiscal measures alone, the staff representative remarked. Moreover, the overhang of debt service obligations--which would require the generation of substantial budgetary surpluses--posed additional problems for the maintenance of present currency arrangements. Nonetheless, the authorities remained strongly opposed to a change in the system. He recognized that there were legitimate concerns about a further weakening of financial discipline if Liberia were to move to a monetary system based on its own currency; thus, every effort must be made to implement immediately and forcefully the measures necessary to correct the fiscal imbalances and the arrears problem.

The staff representative from the IBRD recalled that Directors had raised two issues concerning World Bank activities in Liberia. The first concerned public enterprises; the staff of the Bank had been able to agree with the Liberian authorities that they should issue a policy statement on public enterprises in the spring of 1985. The authorities had also advanced legislation to create a Bureau of State Enterprises, aimed at overseeing the sector and recommending policies for it. The legislative process had been under way for some time, and he had the impression that it had not advanced much recently.

A number of the actions to be taken under the proposed structural adjustment loan required some prior studies, which it had been hoped would be financed through another parallel credit, the staff representative said. Since the parallel credit had not become available, work on the studies had not proceeded as hoped, although some less comprehensive work would be done shortly. Still on the public sector enterprises, he observed that progress in dealing with the problems of the Petroleum Refinery Corporation, an important feature of the program, was not likely for some time.

Other Bank operations in Liberia had been affected by the overall economic situation, the staff representative from the IBRD continued. In the face of substantial arrears to the Bank, two project loans--which had been brought to the Executive Board in late March and early April--had not been signed. Moreover, the structural adjustment loan negotiated in March 1985 had not yet been put to the Executive Board and would not be submitted until it was clear that a viable financial program and financing were in place and that the arrears to the Bank had been eliminated. For all existing projects, disbursements to Liberia had been suspended in late February and had not been resumed.

Mr. Mtei, noting that the staff had comprehensively answered most of the technical questions raised by Directors, said that he would limit himself to a few personal remarks that he hoped would help Directors to appreciate the difficulties of the Liberian situation. First, it was regrettable that the staff report had been prepared in such a way that it could not be used by the authorities to mobilize the resources that would enable Liberia to become current in its current financial obligations to the Fund and the World Bank. It had been his understanding that, following the Article IV consultation discussion, the staff and the Liberian authorities were to have worked out an understanding making possible the issuance of a memorandum--even if only a provisional memorandum--that would have formed the basis for a future adjustment program that could be supported by the Fund. With such a draft memorandum in hand, the Liberians would have been able to approach donors and other creditors with a view to mobilizing resources sufficient to meet their overdue obligations to the Fund. Unfortunately, that understanding had not yet been reached between the staff and the authorities, although he remained hopeful.

One of the issues that had attracted the attention of a number of Directors was the monetary system of Liberia, Mr. Mtei recalled. Evidence suggested that the liquidity problem that had emerged in recent years was basically a reflection of the institutional arrangements that characterized the monetary system; it was his personal view that the problem related more to institutional arrangements than to a shortage of liquidity. Two factors in the monetary system were important in that regard. First, the National Bank of Liberia was not a bank of issue, except for the few coins referred to in the course of the discussion. Second, export earnings were not required by law to be surrendered to the National Bank as foreign exchange reserves of the country, thus rendering the trade surplus almost meaningless in traditional balance of payments accounting. For that reason, the National Bank of Liberia and the Government could not earmark any proceeds of Liberia's exports to pay the Fund or the World Bank. They would have been able to do so if they had had the means of accumulating the export proceeds and allocating the right priority to their use. However, the monetary arrangement had become a major issue only during the current economic crisis, as the system appeared to have worked well in the past.

Again speaking personally, Mr. Mtei agreed with Mr. Polak that, theoretically, the U.S. dollar base of the currency arrangements for Liberia had been meant to produce some stability in the country's finances. However, that stability had not occurred, and the authorities had begun to look for an escape route by issuing coins not backed 100 percent by dollar holdings and by accumulating arrears in their external payments obligations. In his view, the Fund staff should be presenting to the authorities concrete proposals for tackling that problem and, if necessary, should be able to advise the authorities that the best solution was for them to issue a currency of their own and to adopt the conventional rules of a central bank as the reserve holder for Liberia. Of course, the timing of such a step was crucial, and confidence in any new system would be vital if it were to work. Again, the views that he had put forward were his own and not those of his authorities.

Another point to be made was related to the question of exchange rate policy in Liberia, Mr. Mtei considered. The staff had pointed out that the Liberian dollar had appreciated significantly in nominal and real terms over the past six years but had acknowledged that "an independent exchange rate policy is precluded by the current monetary arrangement" and that external competitiveness of the tradable goods sector could be achieved only by increased productivity and a compression of domestic costs, especially wages. Since there was a limit to which productivity could be increased and wages could be compressed, and given the appreciation of the U.S. dollar, he would have expected the staff to have produced some alternative solution for relieving the real problem faced by Liberia in export competitiveness. In discussing the problem, Directors should be cautious not to be perceived as considering that the problem had been created by acts of omission or commission on the part of the Liberian Government. The appreciation of the U.S. dollar had of course affected other countries as well as Liberia, and he wondered whether the staff could be more precise about what it would recommend as the appropriate course of action in the circumstances.

Some Directors had expressed concern that the Government's commitment to the adjustment process was perhaps becoming lax, Mr. Mtei noted. In fact, the authorities had been working closely with the Fund staff for the past five years and had on numerous occasions demonstrated their willingness to follow Fund advice. They had asked him to reassure Directors that they were not abandoning the adjustment process and would make every effort to improve the current situation. It should perhaps be added that the situation of Liberia demonstrated the difficulty of pursuing austerity measures in an environment of declining economic activity and major structural weaknesses. Social concerns sometimes had to be given high priority, particularly when the standard of living continued to fall, but that did not mean that the Government was any less committed to the adjustment process.

In concluding, Mr. Mtei stressed that the Liberian authorities were well aware of the deviations from the recommended adjustment path in 1984/85 and that expenditure control was vital. They were also making efforts to improve tax collection. The authorities did not regard the issuance of domestic currency as a substitute for adjustment, and they were aware of the evidence available suggesting that an independent currency had not led to better economic performance in many other countries. It was simply that, faced with a liquidity squeeze, the authorities had sought to create some room for maneuver.

The Chairman observed that if the staff report seemed to Mr. Mtei not sufficiently positive to promote mobilization of external resources, that was probably because the staff had been unable to find evidence of the type of policy measures that would have permitted a more positive assessment of Liberia's economic situation.

The Chairman then made the following summing up:

> Executive Directors agreed with the thrust of the staff appraisal in the report for the 1985 Article IV consultation with Liberia. They expressed disappointment that the initial progress toward adjustment achieved in 1983/84 had been eroded during 1984/85 owing to a lack of commitment by the Liberian authorities to implementing the policy measures that had been agreed in the context of the 1984/85 adjustment program. They were greatly concerned about the sharp deterioration during the past year in the government budgetary operations, which had resulted in the rapid accumulation of arrears, both domestic and foreign.
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> Directors noted that the enlarged deficit was in substantial part attributable to the failure of the Government, contrary to its stated intentions, to implement needed tax measures and to avoid extrabudgetary expenditures. The large amount of unidentified extrabudgetary expenditure was particularly worrisome, as was the fact that the 1984/85 fiscal deficit--which in the program under the stand-by arrangement had originally been estimated at 4.9 percent of GDP--had been revised upward to more than 15 percent of GDP.
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> Directors acknowledged the progress made in rationalizing the public enterprises and urged the authorities to accelerate their efforts toward that end in cooperation with the World Bank. The problem of the refinery was mentioned as particularly important in that regard.
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> Noting that the fiscal area must be the focus of adjustment in Liberia, Directors urged the authorities to take immediate steps to restore firm fiscal discipline and to take the necessary measures to meet current debt service obligations falling due so as to prevent a further increase in the accumulation of external arrears. Without immediate stringent and sustained efforts to increase revenues and control expenditures, the present and prospective budget deficit could not be financed in an orderly manner; concern was expressed that disorderly fiscal developments would gravely undermine the viability of the financial system.
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> Taking note of the significant erosion in Liberia's external competitiveness, a phenomenon compounding the difficulty of fiscal adjustment, Directors questioned the authorities' ability to maintain the existing monetary arrangement in which the Liberian

dollar is pegged at par with the U.S. dollar, which is also used as a circulating currency. Some Directors noted the recent accelerated issuance of coins not backed by dollar reserves, and wondered whether the present de facto "dual" monetary system that was emerging represented a viable mechanism. Those Directors questioned the desirability of maintaining the peg arrangement and thought that consideration should be given to complementing the needed fiscal adjustment with supporting monetary and exchange rate policies. However, those Directors stressed strongly that any shift away from the dollar peg system would make sense only if the resulting greater monetary autonomy were used to restore the competitiveness of the economy and not to finance uncontrolled fiscal deficits.

Unless and until comprehensive adjustment measures were adopted, Directors remarked, Liberia risked losing the cooperation of the international donor community, which it very much needed to help resolve the deep-seated fiscal and external imbalances.

Finally, Directors reiterated their very serious concern regarding Liberia's growing payments arrears to the Fund and urged the authorities to give the highest priority to eliminating those arrears.

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

The Executive Board adopted the following decision:

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/85/188, which may give rise to such restrictions. The Fund urges the authorities to eliminate these payments arrears as soon as possible.

Decision No. 8038-(85/112), adopted
July 24, 1985

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/85/111 (7/24/85) and EBM/85/112 (7/24/85).

2. SUDAN - TECHNICAL ASSISTANCE

In response to a request from the Sudanese authorities for short-term technical assistance in the context of the tax reform measures that are being planned, the Executive Board approves the proposal set forth in EBD/85/184 (7/18/85).

Adopted July 24, 1985

APPROVED: April 15, 1986

LEO VAN HOUTVEN
Secretary