Liberia Program Grant IV

(669-K-604)

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Liberia Program Grant IV (669-K-604)
PAAD Amendment No. 3

A. Summary and Recommendations

Immediately after the April 1980 coup, the new GOL found itself faced with worsening inflation, deterioting terms of trade, disinvestment and capital flight, difficulty in financing its oil import bill, general lack of confidence, a drop-off in business activity, and inadequate sources to meet all of its legitimate needs. At the same time, in the heady early days of the revolution, the GOL doubled the minimum salary of soldiers and civil servants, substantially increasing its recurrent obligations. These factors led to a rapidly crumbling financial situation. The United States Government provided Economic Support Funds or Program Grants to assist the government to revive its economy and reestablish political stability. These Program Grants helped the GOL meet specific fiscal needs: budgetary support and essential external obligations, i.e., oil payments, rice imports, foreign debt servicing. Four Program Grants have been provided to the GOL: One in FY 80, two in FY 81 and one in FY 82.

ESF Program Grant I. On August 26, 1980 the first ESF Grant Agreement ($5 million) was signed by the GOL. These funds were allocated to help selected Liberian Mininstries responsible for economic and social development to continue activities. Without this assistance ministries would have had to suspend ongoing activities due to GOL's inability to adequately fund recurrent budgets.

ESF Program Grant II. A second grant of $7 million was provided on December 18, 1980 as Liberia's fiscal crisis continued to deteriorate, despite efforts to meet the terms of the IMF stand-by agreement The major reason for the continuing crisis was the inexperience of Liberia's new government, which resulted in excessive expenditures, and reduced international and local business confidence.

ESF Program Grant III. In early 1981, the USG undertook a reappraisal of the GOL's likely needs for the remainder of the U.S. fiscal year in the light of more realistic projections for the GOL's fiscal requirements. Particular attention was given to the government's inability to meet the country's essential foreign obligations. Since overseas lines of credit dried up in the wake of the 1980 coup d' etat, the National Bank has had difficulty in transferring dollars overseas to make offshore payments.

As a result of this analysis, and a policy decision to commit the United States Government to provide the financial resources necessary to meet Liberia's most pressing needs, the USG provided another Program Grant, $25 million, on May 19, 1981. These funds were considered adequate to meet this objective through September 30.

ESF Program Grant IV. On November 20, 1981 a fourth Program Grant was provided and was used to help the GOL meet its requirements under the IMF standby agreement. This grant was for $10 m.

ESF Program Grant IV, Amendment No. 1. On January 26, 1982, the U.S. government approved a $6.0 million supplementary ESF to enable GOL to meet an unexpected offshore cash shortfall at the end of last year.

In total, the USG has provided Liberia with $52 million in ESF assistance since the April 1980 change in government.

Thus far ESF support has enabled the GOL to (a) continue to pay its oil bills, (b) meet IMF targets on debt servicing and (c) continue to pay government workers. It has also insured that sorely needed funds continue to flow to selected key development projects and has helped GOL adherence to the= IMF standby arrangement and its quarterly performance criteria. Liberia in March 1982 received its third quarterly tranche from the IMF under the 1981/82 arrangement.

Yet, the timing of IMF tranches and ESF flows continues to be out of synchronization with Liberia's need to make offshore payments. On its part the NBL has projected these flows on a prorated basis, but actual foreign exchange requirements have been such that a $29 million shortfall 1/ will occur before the end of Liberia's current fiscal year (June 20, 1982). It is therefore recommended that the U.S. government approve a third amendment to Liberia Program Grant No. 669-K-604 in the amount of $19 million. Notation: ESF Program Grant IV. Amendment No. 2, changed the Special Account deposit from being made in a "commercial bank" to the "National Bank of Liberia" the Amendment required that funds in the Special Account be segregated from other Government funds deposited in the National Bank of Liberia.

B. Background

Liberia's economic difficulties, which became apparent in 1979, were aggravated by the April 1980 military takeover, as well as by external economic factors over which Liberia has no control. The crisis has essentially five elements: (1) a domestic economy which began to stagnate in 1977 and has registered a negative real growth rate of between minus 4 and 5 percent annually over the past two years; (2) a public sector foreign exchange crisis due to increased and accelerating external financial obligations, posed against reduced foreign exchange.

1/ USAID calculations indicate a far worse situation, especially if the IMF targets are breached; i.e. a possible offshore gap of $55.7 million by 30 June 1982.

and revenue earnings to service these obligations; (3) near fiscal collapse which has its origins in large and persistent budget deficits which can only be financed by severe austerity measures to bring expenditures into line with domestic revenues; (4) no liquidity at the National Bank because of government overdrafts and (5) a lack of confidence by the business sector in the current government's ability to put its fiscal/financial house in order, which in turn is reflected in reduced levels of liquidity, investment and business activity and, therefore, revenues. These elements are interrelated and, therefore, interact with each other. A solution to the current crisis has to address all five elements, while no one party, external or domestic, can resolve the situation by itself.

Despite a favorable trade balance, Liberia has a considerable current account deficit caused by a large negative "service" component. The GOL has virtually no foreign exchange and only very limited lines of credit to finance its external transactions. This situation is illustrated by monthly recurring last minute scrambles to pay oil bills, service debt and find cash to pay government workers. It reflects a loss of confidence in the National Bank of Liberia (central bank) which in turn is due to the GOL's indebtedness to the Bank to help finance its operations and deficits (as of April 1, 1982 this amounted to $168.3 million). The latter is the root cause of the problem. The fact that Liberia uses the U.S. dollar as its currency -- although fundamentally beneficial -- limits the Government's monetary flexibility, tends to exaggerate problems in short-term adjustments to liquidity constraints and makes financial control more difficult.

The budget deficit has grown sharply since 1979. By IMF definitions it amounted to $88 million in GOL FY 1979/80; $100 million in 1980/81. This amounts to roughly 10 percent of GDP and constitutes more than 40 percent of domestic revenues. The deficit has its origins in reduced revenues, reflecting slow-downs in major export industries as well as in the domestic economy, but more significantly in expenditures. The expenditure side of the problem consists of the following parts: (1) bloated military and civil services with an unaffordably large salary component, (2) a large number of unprofitable and mismanaged public corporations which are a drain on public funds, (3) ineffectual attempts at expenditure control, and (4) a mounting debt service (partially a legacy of 1979-1980 Plan implementation and the 1979 OAU conference hosted here, and partially a result of runaway expenditures in the immediate post-coup period).

Government salaries ($156 million), debt servicing ($78.3 m) and subsidies to unprofitable state corporations ($24 m) are the main causes of the deficit; while the annual oil import bill ($160 million) and external debt servicing are the main causes for the balance of payments difficulties. Wages constitute 64.5 percent of recurrent operating expenditures of government. IBRD projections show debt service increasing from 31 percent of expected revenue in FY 1981/82 to 38 percent in FYs 1982/83 and 1983/84, and not declining below 20 percent of revenues until 1986/87. Debt servicing will continue to be a tremendous burden to government for most of the current decade.

The Government has tried to control expenditures, but only with limited success and with concomitant mounting levels of unpaid checks. Despite heavy new taxes (one of the heaviest burdens in Africa) and a tough IMF agreement to hold down expenditures,, spending targets for FY 1981/82 are currently being exceeded. Meanwhile the economy falters. All of the major sectors in the economy are negatively affected by adverse trends in the world economy. It will not be easy to overcome this crisis, as the external economic environment is likely to remian un-congenial for several years.

However, longer term prospects for the Liberian economy are fairly good. The country is rich in natural resources and has considerable unexploited reserves (iron, diamonds, timber, uranium) while cash crop markets for rubber, coffee and cocoa are expected to recover from cyclical lows. Liberia is exploring possible off-shore oil deposits.

Government Revenue and Expenditure
1976/1977 - 1980/1981

	1976/77	1977/78	1978/79	1979/80	1980/81
:venue and Grants	182.5	201.5	224.9	225.8	254.1
Revenue	166.5	185.5	201.9	202.8	217.9
Grants	16.0	16.0	23.0	23.0	36.2
:penditure	209.1	273.9	365.7	313.7	353.6
Recurrent	108.5	122.3	152.9	179.7	237.8
Development	100.6	151.6	212.8	134.0	115.8
7erall Deficit	(26.6)	(72.4)	(140.8)	(87.9)	(99.5)

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Under the monetary system in Liberia where the U.S. dollar is used as the national currency, it is not possible for Government to print money in order to finance budget deficits. The use of the dollar has a number of advantages. At the same time, because the money supply cannot be expanded at the will of Government, the system imposes strict monetary discipline. While this circumstance has a positive influence in deterring uncontrolled printing of money, it also means that Liberia cannot, over the long run, sustain budget deficits through expanding its money supply. It is imperative that fiscal policy aim at minimizing such deficits.

The present financial crisis which the country faces has its roots in the period 1976/80. Since 1976 the Government has run large, growing deficits which have been financed by foreign borrowing -- mainly high interest commercial loans which are now coming due.

Not only is the deficit large when viewed in relation to Liberia's past, it now is comparatively one of the largest in Africa. If one takes the budget deficit as a percentage of expenditure, Liberia's deficit was 28 percent in 1981 and has averaged 26.9 for the past five years. During this period only five other countries in Africa had higher deficits, including Ghana and Sierra Leone (both of which have economies which are in grave trouble). It is clear that these deficits are largely responsible for the present financial crisis, making the country totally dependent on foreign cash support to finance the shortfalls. It is also clear that the economy will not be restored to a healthy position until the deficits are eliminated. In view of the size of the deficit bequeathed to and exacerbated by People's Redemption Council (PRC) Government (due in part to the 1980 increase in salaries granted security forces and lower paid government workers, and an increasingly costly military establishment), this will be an enormous task -- one that will require drastic steps to both reduce expenditures and raise revenues.

In an effort to increase revenues and bring the budget deficit within manageable bounds, the Government has raised significantly a number of taxes and fees over the past two years. This effort was done in concert with the IMF which entered into a stand-by agreement with GOL whereby it would provide financial support for a two year period. In turn, the GOL agreed to observe certain criteria designed to improve fiscal management and financial control. In addition, a condition for the stand-by agreement was that certain controls would be imposed on budgeted expenditures and reductions would be made where possible. Government also accepted a number of performance criteria. During the first year and half of the stand-by the performance criteria have been observed, though with difficulty. Should GOL fail to meet performance criteria, the implications are grave: Government would not receive IMF financial support that is essential to finance the most basic expenditures during this fiscal year, e.g., salaries, oil payments, debt obligations. Furthermore, donors as well as commercial banking sector look to compliance with the criteria as a barometer for Liberia's financial stability. Should the criteria not be met, assistance from other sources may be threatened, and the negotiations to reschedule both public and commercial debt (through the Paris and London Clubs) could be put in jeopardy.

C. Changes in the Economic Situation Since the Original PAAD was Authorized

None

D. Gap Analysis

(1) Revenue Performance

OURCE:	ESTIMATED REVENUE JULY'81 - JAN '82	REVENUE COLLECTED JULY'81 - Jan.'82	EXCESS (DEFICIT) JULY'81 - JAN'82
axes on Int'l Trade	$41,333,000.00	34,201,975.28	(7,131,024.72)
xport Duties	750,000.00	439,697.95	(310,302.05)
xport Duties-Logs	-0-	94,862.22	94,862.22
xport Duties-Gold	-0-	49,497.03	49,497.03
onsular Fees	9,300,000.00	9,594,083.52	294,083.52
anor River Bridge Tolls	-0-	3,243.00	3,243.00
iscellaneous	-0-	3,940.70	3,940.70
ther	260,000.00	318,370.31	58,370.31
axes on Domestic Products	15,985,000.00	7,485,754.94	(8,499,245.06)
aritime Revenue	$15,825,000.00	16,383,191.73	558,191.73
orporate & Partnership	8,600,000.00	9,826,517.75	1,226,517.75
irestone Corp.	-0-	-0-	-0-
ibeth Corp.	-0-	1,780,000.00	1,780,000.00
Individual	31,210,000.00	32,093,716.99	883,716.99
ubber Sale	1,243,000.00	943,232.14	(299,767.86
Iron Ore Profit Sharing	4,040,000.00	964,083.45	(3,075,916.55)
ther (L.P.M.C.) Dividend	-0-	-0-	-0-
ational Reconstruction Tax	9,500,000.00	7,019,613.11	(2,480,386.89)
axes on Non-Residents	1,140,000.00	390,398.64	(749,601.36)
axes on Prop. & Cap. Trans.	1,250,000.00	967,224.21	(282,775.79)
ealty Lease Tax	445,000.00	651,072.71	206,072.71
otor Vehicle Revenue	989,000.00	1,825,622.67	836,622.67
ther Taxes	2,628,000.00	1,888,251.12	(739,748.88)

SOURCE:	ESTIMATED REVENUE JULY'81 - JAN'82	REVENUE COLLECTED JULY'81 - JAN'82	EXCESS (DEFICIT) JULY'81 - JAN'82
evelopment & Prog. Tax	613,000.00	372,953.53	(240,046.47)
epartmental Revenue	505,000.00	521,144.19	16,144.19
tumpage fees	5,950,000.00	3,231,446.28	(2,718,553.72)
and Rental	860,000.00	336,616.22	(523,383.78)
on-Tax Rèvenue	5,553,000.00	5,259,625.00	(293,275.00)
old Proceeds	-0-	-0-	-0-
laughter House	-0-	25.00	25.00
iscellaneous	-0-	175,032.49	175,032.49
onfiscated Fund	-0-	21,514.74	21,514.74
Total Internal Receipts:	$157,979,000.00	136,842,706.92	(21,136,293.08)
National Savings Bond	-0-	3,651,577.61	3,651.577.61
xternal Borrowing - SDR:	-0-	8,526,854.84	8,526,854.84
otal INt. & Ex Rec.	157,979,000.00	149,021,139.37	(8,957,860.63)

(2) Cash flow Analysis

GOL Cash flow ($m)

	Est FY 1981/82	Act. Dec 1981	Act. Feb 1982	Proj. thru June 1982
evenues	268.0	107.3	154.0	231.0
Grants	72.1	22.5	28.4	35.0
Loans	50.8	21.2	27.2	33.0
Total sources	390.9	151.0	209.6	299.0
Recurrent	276.0	124.1	166.9	257.8
alaries	(156.0)	(77.7)	(105.3)	(156.0)
nterest on debt	(37.0)	(15.0)	(18.4)	(37.0)
other	(83.0)	(31.4)	(43.2)	(64.8)
principal on debt	43.4	15.0	18.4	27.6
encumbances	4.9	5.1	5.2	5.3

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	Est FY 1981/82	Act Dec 1981	Act Feb 1982	Proj. thru June 1982
lopment	126.9	44.2	58.7	78.3
ı. financed	(60.0)	(26.2)	(34.7)	(43.3)
ign financed	(66.9)	(18.0)	(24.0)	(35.0)
Total uses	436.0	188.4	249.2	369.0 1/
deficit	45.1	37.4	39.6	70.0
ncing				
Foreign borrowing (net)				30.0
Domestic (NBL)				40.0

1/ The "total uses" amount is kept artificially low by (a) reducing development expenditures, (b) increasingly resorting to the use of unpaid checks accumulation ($28 million at the end of February 1982) -- these are checks in payment for goods and services consumed by GOL, which are not released. GOL continues to owe these debts.

NBL Projections (April 1, 1982)
Offshore Receipts and Payments from April to September, 1982
(in millions of $)

Income	April	May	June	July	Aug.	Sept.	Total
fshore Tax ceipts	4.0	4.0	4.0	3.0	3.0	4.0	22.0
finery Off-ore receipts	4.0	4.0	4.0	4.0	4.0	4.0	24.0
blic Sector ports	4.0	5.0	3.0	3.1	-	-	15.1
vance Payments r coffee	-	5.0	-	-	-	-	5.0
F drawings	3.0 (reserve) (tranche)	-	12.6	-	-	-	15.6
F - U.S. ant	-	9.0	-	-	-	10.0	19.0
Total	15.0	27.0	23.6	10.1	7.0	18.0	100.7
penditure							
sh for monthly yroll	5.4	5.8	6.5	6.5	6.5	6.5	37.2
l Payments	4.1	21.7	11.0	11.0	11.0	11.0	69.8
reign debt yments	5.0	9.0	6.9	5.0	5.0	5.0	35.9
yments to bassies	2.0	0.5	0.5	1.0	1.0	1.0	6.0

Income	April	May	June	July	Aug.	Sept.	Total
s/oil purchase	1.5	-	-	-	-	-	1.5
IF Charges	3.0	1.2	-	2.8	1.2	-	8.2
scelleanous yments	0.5	1.5	0.5	1.0	1.0	0.5	5.0
ecks on hand	8.0	-	-	-	-	-	8.0
Total	29.5	39.7	25.4	27.3	25.7	24.0	171.6
Shortfall	-14.5	-12.7	-1.8	-17.2	-18.7	-6.0	- 70.9

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