

Liberia's External Debt: Moving Towards Comprehensive Debt Relief

By Steven Radelet

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ABSTRACT

In this essay, CGD senior fellow Steve Radelet describes Liberia's debt situation and the key issues in moving forward on debt relief with the IMF, World Bank, African Development Bank and bilateral creditors. He explains why it is important for Liberia's recovery that the international community act quickly and outlines the key steps necessary for Liberia to achieve a debt deal before the end of 2007.

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**Steven Radelet
Center for Global Development
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I. Introduction

Liberia's long and brutal civil war finally came to an end in 2003. The new government of President Ellen Johnson Sirleaf is off to a fast start in implementing key reforms and establishing the foundation for sustained economic development and poverty reduction. But the government inherited massive external debts amounting to at least \$3.7 billion (valued at end-2005), the majority of which was borrowed in the early 1980s by the regime of Samuel Doe. The Doe regime stopped making payments in the mid-1980s, and accrued interest and penalties since that time have more than doubled Liberia's debt. The Net Present Value (NPV) of Liberia's debt relative to GDP (800 percent) and exports (3,000 percent) are among the highest, if not the highest, in the world. About 45 percent of the debt (\$1.6 billion) is owed to multilateral agencies, primarily the IMF, the World Bank and the African Development Bank (AfDB). About 25 percent is owed to bilateral creditors, and the remaining 30 percent is owed to commercial creditors (see Table 1).

Liberia is currently not making any payments on this debt, except for tiny symbolic payments to the IMF, World Bank, and AfDB. Fortunately, no creditors are requesting or expecting payments, given Liberia's extraordinarily difficult economic situation. To put the government's financial situation in perspective, total revenues in FY 2005/06 were \$80 million, and in FY 2006/07 are projected to be about \$130 million. This latter amount is equivalent to about \$40 per Liberian for all public spending, one of the lowest ratios in the world. The debt level is 28 times higher than total government revenue, and paying just 1 percent of the debt would eat up more than one-fourth of all government revenues.

Clearly, Liberia's external debt is unsustainable, and there is no way that it can repay these debts. Moreover, it should not be expected to pay these debts. There is no justification for holding today's Liberian citizens responsible for funds that international institutions and commercial banks unwisely lent to the rapacious dictatorship of Samuel Doe more than 25 years ago. Doe took power by a coup, ruled by force, and illegitimately borrowed these funds without the consent of the people of Liberia. This is a clear case of odious debt.

Under these circumstances, the official international community is correct to expect no repayment, and other creditors should be expected to follow suit. Thus, the government and its major creditors have initiated a process that should lead to the complete elimination of the majority of these debts and a substantial reduction of those that remain. However, the process is complicated because of the large size of Liberia's debts, the fact that almost all of the debts are in arrears, the country's clear inability to make payments following the devastation of the economy, and—unique so far among HIPC countries—the lack of “financing assurances” from the shareholders of the IMF, World Bank and African Development Bank on financing Liberia's debt. The process is likely to take at least until late 2008 and will probably extend into 2009. It could take longer unless key steps are urgently taken in the next few weeks and months.

After some progress during the February Liberia Partner's Forum, there had been hope that donors would move forward and reach decisions on financing issues during the G7 Finance Minister's meeting on April 13 and the spring meetings of the IMF

and World Bank on the following weekend. But no firm decisions were forthcoming. The finance ministers discussed the issue, and to their credit, included Liberia in their official communiqué, saying “We advocate a rapid resolution to Liberia’s arrears to the international financial institutions. Available internal resources should be fully used to this end. We are prepared to make additional financial contributions.”¹ While this statement is welcome, it falls short of the commitment and decisions needed to finance Liberia’s debt relief.

Some have argued that the issue is not particularly pressing, since Liberia is not making any debt service payments. However, **rapid resolution of the debt problem is crucial for several key reasons:**

- First, resolving the arrears issue will open up sources of new funding for development programs, most importantly from the African Development Bank, but from other donors as well.
- Second, Liberia is in a delicate transition from 14 years of war to a new democracy, and it is important that Liberians see tangible results as soon as possible. Since the debt burden is one of the most visible signs of the gross mismanagement of the past, resolving that issue quickly will provide a significant political boost to the government.
- Third, the Liberian government faces a wide range of critical challenges, and has only a small number of skilled personnel to solve them. The details of moving towards debt forgiveness are eating up large amounts of the valuable time of senior officials. The sooner the debt issue is resolved, the sooner the government can devote more of its attention to other key issues of financial management, good governance and poverty reduction.

The next section of this essay describes the Heavily Indebted Poor Country (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI), which together provide a framework for a comprehensive approach to reducing Liberia’s debt burden. Section III briefly describes an important issue for Liberia that other HIPC countries have not had to face: the need for the IMF and World Bank to obtain “financing assurances” from their shareholders to cover the costs of debt relief before the process can begin. Sections IV through VII briefly examine the specific situations with the IMF, World Bank, AfDB, bilateral and commercial creditors, respectively.

II. Key Steps in the Process

There are several key steps towards debt forgiveness for Liberia. The timing of these steps is still uncertain, and depends on Liberia’s ability to achieve certain policy and institutional benchmarks of progress, and—critically—on decisions by the shareholders of the IMF, World Bank and African Development Bank on how to finance debt relief, as described in more detail in the next section. But while the timing is uncertain, the broad outline of the major steps is reasonably clear.

¹ For the full communiqué, see <http://www.marketwatch.com/news/story/text-g7-communicue/story.aspx?guid=%7B221C9150-1E98-4C57-92CE-B5D05371B85C%7D>

Arrears Clearance

Liberia's debts are not just large, they are in arrears because of two decades of nonpayment. As a result of its arrears, Liberia has lost some of its rights within the International Financial Institutions (IFIs) —the IMF, World Bank and AfDB. For debt reduction to proceed, at an early stage Liberia's arrears must be cleared so that its loans are technically in good standing with the IFIs.

Contrary to some reports, there is no expectation that Liberia actually must pay the arrears to start the process. Rather, the arrears to the IMF will be cleared through a bridge loan from a third party, probably the U.S. Treasury. This type of operation, which is essentially a large refinancing, has been used in several other countries. The process will happen through several legally discrete steps, all of which will take place in a few hours on the appointed date. First, the U.S. Treasury will make a loan to Liberia in an amount equal to its arrears with the IMF. Second, Liberia will pay the IMF in full. Third, the IMF Board will declare Liberia to be in good standing, and will immediately issue a new loan to Liberia in the amount just repaid. Fourth, Liberia will use the proceeds of the loan to repay the U.S. Treasury. In the end, Liberia will still owe the IMF the same amount, but it will not be overdue on its payments.

The timing of arrears clearance is uncertain, but at this point it appears it will take place in the latter part of 2007. The key point is that creditors are not expecting any significant payments in advance of formal arrears clearance.

The Heavily Indebted Poor Country (HIPC) and Multilateral Debt Reduction Initiative (MDRI)

The HIPC process is the basic framework through which low-income countries receive significant debt forgiveness from multilateral and bilateral creditors. MDRI is a new component added in 2006 under which qualified debtors can receive 100 percent forgiveness from the IMF, World Bank and AfDB.

The HIPC process is divided into two stages.

- First, Liberia must establish a track record of strong policy performance under an IMF-supported program for at least six months to reach the **Decision Point (DP)**. (As discussed below, officially beginning this track record is a key issue at the moment). At the DP, Liberia will begin receiving "interim" debt relief on a substantial portion of its debt. Interim relief means that debt service payments are forgiven (on qualifying debts) as they fall due, but the debt stock is not yet forgiven. Liberia's DP and its arrears clearance are likely to happen on the same day, which could happen in the latter part of 2007.
- Second, Liberia must fulfill certain additional policy conditions or "triggers" in order to reach the **Completion Point (CP)**, at which time debt stocks are fully forgiven. The specific conditions vary by country, as does the time between DP and CP, but two important conditions are that the country must maintain a satisfactory performance under an IMF-supported program, and it must have prepared and implemented, for at least one year, a full Poverty Reduction Strategy (PRS). For some countries, the time between the DP and the CP has been as little

as one year; for others it is longer. The average period has been 2.9 years. Thus, Liberia could reach its CP by late 2008; more likely it will occur in early 2009.

Under traditional HIPC terms, *bilateral* creditors initially will forgive 90 percent of Liberia's debts to them. *Multilateral* creditors will then forgive the additional amount necessary to reduce the net present value (NPV) of debt outstanding to 150 percent of exports. In Liberia's case, these two steps would entail a debt reduction of approximately 95-97 percent from current levels.

However, in other countries, most bilateral creditors have agreed to go beyond the HIPC requirements and provide 100 percent relief. There is every expectation that most, if not all, of Liberia's bilateral creditors will do the same. The United States, Germany, the United Kingdom, Germany, and China have already announced their intention to forgive 100 percent of Liberia's debts at the appropriate time through the HIPC framework.

In addition to the basic HIPC process, in 2006 the shareholders of the IMF, World Bank and AfDB agreed to go beyond the standard HIPC terms (i.e., debt forgiveness down to the point at which the NPV debt/export ratio is 150 percent) and provide full 100 percent relief for a large group of developing countries under the Multilateral Debt Relief Initiative (MDRI). Liberia was not included in the original group of countries named for MDRI because it was in arrears to the institutions at the time of the announcement. Nevertheless, there is every expectation that if Liberia completes the HIPC process successfully, it will receive 100 percent relief from the IFIs through the MDRI process. Thus, at the end of the process, Liberia is likely to receive 100 percent forgiveness of its multilateral and bilateral debts.

III. The Need for Financing the Costs of Multilateral Debt Forgiveness

However, for Liberia, just *starting* the HIPC process is more complicated than for other countries because the arrangements for financing the costs of debt forgiveness within the IMF, World Bank and AfDB are not yet in place. Until they are, the HIPC process—specifically the performance track record under an IMF program towards the Decision Point—cannot begin.

In the Enhanced HIPC agreement of 1999, financial arrangements were put in place to cover the costs of debt forgiveness within the IFIs for 37 of 40 countries potentially eligible for HIPC. The shareholders explicitly excluded three special country cases with “protracted arrears:” Liberia, Somalia and Sudan. These countries would be eligible for HIPC, but would not be covered by the 1999 financing arrangement. Instead, the shareholders agreed to make appropriate financial arrangements if and when these countries became eligible. Liberia is the first of these three countries to come forward.

No HIPC country to date has faced the challenge that Liberia faces of needing the institutions to arrange financing before the HIPC process can begin. Although Liberia has been performing strongly on an IMF Staff Monitored Program for a full 14 months (as of this writing in mid April 2007), none of that performance officially counts towards the track record for Decision Point. Until the shareholders agree on a

financing package, Liberia cannot establish the type of IMF program that officially counts for the track record, as described in the next section.

In principle, the financing needed for Liberia could come from either (a) internal IMF, World Bank and AfDB resources or (b) new financial commitments from shareholders. There are several options for arranging these “financing assurances,” but the precise details of how this is done is less important for Liberia than ensuring that an agreement is reached.

Two things are crucial for Liberia. First, that the shareholders reach agreement on the financing arrangements as quickly as possible so as to not delay the initiation of the HIPC process any further. Second, that any new funds required for the IFIs (to the extent that internal resources are insufficient) are *fully additional* to planned assistance programs for Liberia, and are not subtracted from funds available for much needed reconstruction programs on the ground. Given the large amounts involved, there is significant concern that new financial commitments to the institutions could reduce direct support for Liberia.

IV. The IMF

Liberia has been implementing policies under an IMF Staff Monitored Program (SMP) since February 2006. By all accounts, its performance to date has been strong. Going forward, the government and IMF staff has designed the 2007 SMP so that it meets the standards of “upper credit tranche conditionality.” Liberia’s policy performance is therefore not a constraint at the moment to moving forward with initiating the HIPC process.

Instead, the constraint is the lack of financing assurances. Until financing assurances are arranged, Liberia cannot begin its performance track record towards the Decision Point. Under the current HIPC rules, Liberia’s HIPC track record can only begin once it is formally on an “IMF-supported” program (such as a Rights Accumulation Program or a Poverty Reduction and Growth Facility Program). For technical reasons, performance under an SMP does not count. But the IMF Board will not formally approve any of these programs until financing assurances are in place for the costs of the HIPC debt relief. Only then could Liberia begin to establish the six-month track record needed to reach the Decision Point.

Approximately \$800 million will be needed for full HIPC and MDRI treatment (i.e., 100 percent forgiveness) of Liberia’s obligations to the IMF. The majority of these funds are likely to come from internal IMF resources, but a significant portion is likely to be needed in new contributions to the IMF.

Discussions among IMF management and key shareholders on the financing issue have been ongoing for more than a year. There has been some slow progress, particularly in the last few months. With respect to internal resources, discussions have focused on using the resources in two accounts held by the IMF on behalf of shareholders—the Special Contingent Account-1 (SCA-1) and deferred charges

accounts.² Many shareholders have agreed to allow the IMF to use their shares of these accounts to finance Liberia's debt relief. But some others are reluctant to do so, including some low-income shareholders that might prefer to be reimbursed rather than have the funds used for Liberia.

As a result, there is still uncertainty about how much can be generated by these accounts, and therefore how much will be required in new contributions from shareholders. It is likely that new contributions of \$100-\$150 million will be needed, and possibly more. Moreover, whatever the final amount needed, shareholders are continuing to debate the appropriate burden-sharing among themselves to cover those costs. Several shareholders have indicated their intention to provide their share. The United States is the only country to have made a public announcement, stating that it would seek approval from Congress for up to \$35 million from the FY07 budget for use at the IMF and AfDB (in addition to \$15 million committed earlier for the AfDB), with the amount for each institution not yet determined.

As of this writing (in mid April 2007) there is hope that decisions can be reached in the next few weeks on the financing assurances. While the opportunity of the spring meetings of the IMF and World Bank has passed, decisions could be made as part of the G8 summit process. An agreement would allow Liberia to begin to formally begin its performance track record towards Decision Point. But it could take longer, which would delay the DP and ultimate debt relief for Liberia.

V. The World Bank

The process with the World Bank is more straightforward, and there has been more progress towards putting into place the necessary arrangements. About \$450 million is needed to clear Liberia's arrears to the Bank, slightly less than the total amount of debt outstanding.³

World Bank management has developed a solution that would not require new financing from shareholders, and instead would rely fully on internal Bank financing. Informal discussions are continuing within the Bank and with its shareholders on this approach. If this arrangement is ultimately approved by the Board, the World Bank could move quickly to clear the arrears. At that point, Liberia would be able to restore all of its privileges within the Bank, including normal access to IDA financing.

² These two accounts are the IMF's rough equivalent of a commercial bank's provisioning accounts for non-performing loans. According to the IMF website, "in 1986, a "burden-sharing" mechanism was introduced so that any loss of income by the IMF because of overdue obligations is spread equally among creditor and debtor members. Under this mechanism, the interest rates charged to borrowers and paid to creditors are increased and lowered, respectively. Additional adjustments to the basic rates of interest charged and paid generate resources for a SCA-1, established specifically to protect the IMF against the risk of loss of principal resulting from arrears." The website further notes that "amounts collected in this way are refunded when overdue interest charges are settled." Since these accounts are technically held by the IMF on behalf of shareholders and refunded to shareholders when overdue charges are paid, each shareholder must agree that its share of these accounts can remain with the IMF to be used to finance Liberia's debt forgiveness.

<http://www.imf.org/external/np/sec/pn/2003/pn0364.htm>

³ Some of Liberia's concessional IDA loans have long repayment periods, and principal payments that have not yet fallen due are not in arrears.

However, the IMF and World Bank have an informal agreement that the two institutions move in tandem to clear a country's arrears, with a view toward providing comparable treatment and a comprehensive approach. Thus, the World Bank seems likely to await a solution within the IMF before it formally proceeds towards arrears clearance.

VI. The African Development Bank

The process for the AfDB is a bit different from the other two institutions. To begin with, approximately \$42 million is owed to the Nigerian Trust Fund, a special fund that is administered by the AfDB. Liberia has initiated discussions with the Nigerian government to forgive this debt.

With respect to the remainder of the AfDB debt (approximately \$192 million), the standard agreed process for AfDB debt reduction in post-conflict countries in arrears is that the cost is shared equally three ways: one-third by the Bank, one-third by donors, and one-third by the debtor country. However, the AfDB has altered the arrangement in several cases so that the debtor country pays less than one-third.

Initial discussions for Liberia have centered on a proposal under which the government would make a payment equal to around 1 percent of the arrears, and the AfDB and donors would jointly contribute the remaining 99 percent. Management has proposed an approach in which 70 percent of the remainder would come from internal resources, and 30 percent (slightly less than \$60 million) from new contributions. Unfortunately a few shareholders are resisting this approach and seeking a 50-50 split, which would require much larger amounts of new contributions (approaching \$100 million). There is great concern that this approach would undermine direct financing of programs on the ground in Liberia. Fortunately, most shareholders favor the 70-30 approach, and there is significant hope that shareholders can agree to that formula in the coming weeks.

A few donors have already made pledges for new cash commitments to the AfDB for the \$60 million that will be needed under a 70-30 split. As indicated above, the U. S. government initially pledged \$15 million for the AfDB, and, in February 2007, pledged to make available up to an additional \$35 million to be used for some combination (not yet determined) of financing for the AfDB and the IMF. In addition, the U.K. has pledged to finance up to 10 percent of the amount needed at the AfDB, Norway has pledged up to \$11 million, and South Africa has pledged \$3.5 million. Finding the additional amounts needed to reach \$60 million seems achievable; finding up to \$100 million under a 50-50 split would be much more difficult.

VII. Bilateral Debt

Liberia owes about \$955 million to bilateral creditors, 87 percent of which is owed to Paris Club members. The two largest creditors are the United States (\$358 million) and Germany (\$232 million). The third largest creditor is Taiwan (\$89 million), which is not a Paris Club member. The process of debt forgiveness for bilateral debt (at least

for the Paris Club) will proceed in tandem with multilateral debt relief. At this stage the Paris Club process does not appear to pose any unusual problems.

The most likely scenario is that Paris Club debt reduction will occur at about the same time as Liberia clears its arrears with the IFIs. Formally, Liberia will seek “Cologne terms” from the Paris Club, which is the standard for HIPC cases. These terms offer forgiveness of 90 percent of qualifying debts. Most creditors have voluntarily gone beyond Cologne terms and provided forgiveness of 100 percent of qualifying loans, and there is every reason to expect that this will be the case for Liberia. As noted earlier, the United States, Germany, the U.K. and China have already pledged 100 percent forgiveness, and other Paris Club creditors are likely to follow.

The government also must approach Taiwan, Saudi Arabia and other non-Paris Club creditors and pursue comparable treatment of the debts owed to those creditors. Once again, donors have pledged in the past that debt relief will be fully additional, so it is important that partners adhere to that pledge with respect to bilateral debt relief.

VII. Key Next Steps

It is critical that shareholders of the key institutions move forward in the next few weeks and months and make decisions on the financing of Liberia’s debt relief, perhaps as part of the G8 process culminating in the summit meetings June 6-8 in Heiligendamm, Germany. Decisions over this time frame could facilitate a HIPC Decision Point for Liberia in the latter part of this year.

The key next steps are as follows:

- IMF shareholders must agree to a plan for providing financing assurances within the IMF, including agreeing to return as much as possible from the SCA-1 and deferred charges accounts, and to provide new financing as necessary. This is the key next step, as it will allow Liberia to begin to formally establish its policy track record for Decision Point.
- The shareholders of the AfDB must agree to management’s plan that 70 percent of the necessary financing would come from internal resources, and 30 percent from new financing. In addition, individual shareholders must agree to provide new resources to meet the 30 percent target.
- Nigeria must agree to forgive Liberia’s debts to the Nigerian Trust Fund administered by the AfDB.
- Shareholders of the World Bank must agree to management’s plan to finance Liberia’s arrears clearance fully through internal resources.
- The key shareholders to lead this process and reach agreement are the United States, France, Germany and the U.K. These leaders should commit to finding a solution as quickly as possible, perhaps as part of the G8 process currently under Germany’s leadership.

Table 1: Liberia's External Public DebtTable 5. Liberia: External Public Debt, 2001-05 ^{1/}
(In millions of U.S. dollars)

	2001	2002	2003	2004	2005
Total stock outstanding	2,964	3,051	3,364	3,735	3,659
Multilateral institutions	1,313	1,390	1,572	1,672	1,611
IMF	621	668	739	784	740
World Bank	407	422	499	539	530
AfDB	206	220	250	262	255
IFAD	19	20	20	21	21
OPEC Fund	21	22	22	23	23
BADEA	18	18	18	18	18
EIB	13	15	18	20	19
ECOWAS Fund	4	4	4	4	4
European Union	2	2	2	2	2
Bilateral	712	689	792	1,028	955
Paris Club	633	612	729	894	833
United States	317	313	325	332	358
Germany	137	112	205	250	232
United Kingdom	63	60	46	91	76
Japan	68	78	80	90	56
Denmark	10	12	24	28	17
France	8	6	12	16	16
Italy	6	7	9	57	51
Norway	9	9	12	14	9
Sweden	9	9	9	9	9
Other	6	6	7	7	10
Non-Paris Club	79	77	63	134	122
China	28	27	10	10	8
Kuwait	9	9	10	10	7
Saudi Arabia	25	24	26	26	18
Taiwan	17	17	17	88	89
Commercial	882	915	943	977	1,033
Suppliers' Credit	56	57	57	58	60

Source: Liberian authorities and Fund staff estimates.

1/ Data has been revised to reflect recent information on multilateral debt and to include estimates of interest arrears and late interest charges.

Source: IMF, "Liberia: Staff Report for the 2006 Article IV Consultation and Staff-Monitored Program," April, 2006.