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MEMORANDUM

TO: THE BOARDS OF DIRECTORS

FROM: Donald KABERUKA
President

SUBJECT: LIBERIA : PROPOSAL FOR ARREARS CLEARANCE UNDER THE
ARREARS CLEARANCE PROGRAMME AND POST-CONFLICT
COUNTRY FACILITY*

Please find attached the above-mentioned document.

Attach.

*** Questions on this document should be referred to:**

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**AFRICAN DEVELOPMENT BANK
AFRICAN DEVELOPMENT FUND**



REPUBLIC OF LIBERIA

**PROPOSAL FOR ARREARS CLEARANCE UNDER THE ARREARS
CLEARANCE PROGRAMME AND POST-CONFLICT COUNTRY
FACILITY**

DECEMBER 2007

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LIST OF ABBREVIATIONS AND ACRONYMS

ACWG	Arrears Clearance Working Group
ADB	African Development Bank
ADF	African Development Fund
BWI	Bretton Woods Institutions
CPA	Comprehensive Peace Agreement
DDR	Demobilization, Disarmament and Reinsertion
DFID	Department for International Development
DSA	Debt Sustainability Analysis
ECOWAS	Economic Community of Western African States
EC	European Commission
EFF	Extended Financing Facility
EUR	Euro currency unit
FAO	Food and Agriculture Organization
GDP	Gross Domestic Product
GECL	General Counsel and Legal Services
GEMAP	Governance and Economic Management Assistance Program
HDI	Human Development Index
HIPC	Heavily Indebted Poor Country
I-CSP	Interim Country Strategy Paper
IDA	International Development Association (World Bank)
IFI	International Financial Institution
IMF	International Monetary Fund
I-PRSP	Interim Poverty Reduction Strategy Paper
JISN	Joint Interim Strategy Note
LICUS	Low Income Countries Under Stress
NTLA	National Transitional Legislative Assembly
NEPAD	New Partnership for Africa's Development
NOK	Norwegian Kroner
NPV	Net Present Value
NTF	Nigerian Trust Fund
PCC	Post-Conflict Country
PCCF	Post-Conflict Country Facility
PCSC	Post-Conflict Steering Committee
PRGF	Poverty Reduction and Growth Facility
SDR	Special Drawing Right
UA	Unit of Account
UN	United Nations
UNDP	United Nations Development Program
UNEP	United Nations Environment Programme
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNFPA	United Nations Fund for Population Activities
UN-HABITAT	United Nations Human Settlements Programme
UNHCHR	United Nations High Commissioner for Human Rights
UNICEF	United Nations International Children's Emergency Fund
UNIFEM	United Nations Development Fund for Women
UNMIL	United Nations Mission In Liberia
UNOPS	United Nations Office for Project Services
USD	United States Dollar
WFP	World Food Program
WHO	World Health Organization

EXECUTIVE SUMMARY

1. On July 19, 2004, the Boards of Directors approved general policy guidelines for assisting post-conflict countries (PCCs) to clear their arrears to the African Development Bank Group. The policy guidelines stipulate that arrears clearance programs for PCCs must: (i) create an opportunity for a sustainable normalization of relations with the Bank Group; (ii) lead to positive net transfers to the PCC; (iii) be configured on a case-by-case basis in close coordination with other International Financial Institutions (IFIs) and the Donor community; and (iv) comply with other key financial policies and practices of the Bank Group. The PCC arrears clearance guidelines call for a three-way sharing of the financing costs with contributions from the PCC, Donors and the PCCF determined on a case-by-case basis. In accordance with these principles, this paper proposes a specific arrears clearance program for the Republic of Liberia (Liberia) which complies with the general guidelines.
2. Liberia is emerging from over two decades of civil war, and the prospects for lasting peace and national reconciliation in the country are encouraging. Through its Governance and Economic Management Assistance Program (GEMAP), Interim Poverty Reduction Strategy (I-PRSP) and the 150-Day Program, the country has articulated an economic reform, reconstruction and rehabilitation strategy that is being implemented with the support of its development partners. Clearing Liberia's arrears to the Bank Group will allow full re-engagement alongside the Bretton Woods Institutions (BWIs) to speed up the reconstruction efforts.
3. In Management's judgment, the country has fulfilled the conditions to qualify for an arrears clearance program under the Bank Group's generalized guidelines for PCCs. Liberia meets the five criteria for designation as a PCC by the Bank Group. The country has made significant progress in re-establishing peace, improving political and economic governance, restarting the economy, and promoting resettlement, disarmament and reintegration. Liberia has also been classified as a PCC by the BWIs.
4. Liberia meets the additional criteria to qualify for an arrears clearance program including financial assistance from the Post-Conflict Country Facility (PCCF). Specifically, Liberia is eligible for debt relief under the HIPC initiative and has engaged in coordinated reforms with the IFIs and the Donor community. Since December 2005, Liberia has been making proportional token debt service payments to the Bank Group, the IMF and World Bank, demonstrating non-discriminatory debt servicing.
5. Liberia is being granted maximum flexibility under the PCCF for the following reasons: (i) an extremely heavy and unsustainable debt burden as evidenced by a debt to exports ratio projected at 2094% in 2007 (about 15 times the HIPC threshold) and a debt service to exports ratio greater than 147% (about five times the HIPC threshold); (ii) huge domestic arrears— recently estimated at USD 320 million; (iii) large financial needs for reconstruction of social, physical and economic infrastructure; and (iv) extreme poverty—about 86 percent of all rural households live in poverty. Management is proposing a financing plan that permits the country to pay 1%, bilateral donors to cover 29.7%, and 69.3% from the PCCF. The ADF has received the country's share in the amount of UA 1.62 million, and donors have committed UA 48.13 million to the proposed program to cover their share.
6. Management invites: (i) the Boards of Directors to endorse the assessment that Liberia, as a PCC, has satisfied all the criteria required to qualify for financial assistance from the PCCF; (ii) the Boards of Directors are invited to approve the specific flexibilities required for Liberia's financial circumstances, namely to limit the country's share to a one percent contribution, extend the initial cut-off date of end-December 2003 to end-December 2007 and include in the financing plan the servicing of maturities through end-2008 to prevent reoccurrence of arrears prior to reaching the HIPC decision point; (iii) the ADF Board of Directors to approve a UA 113 million grant from the PCCF to complete the financing plan for the proposed arrears clearance program; and (iv) the Boards of Directors to approve the lifting of sanctions on Liberia upon receipt by the ADF of the relevant payments or instruments, acceptable to the ADF, evidencing Donors' irrevocable financial commitments.

I. INTRODUCTION

1. On July 19, 2004, the Boards of Directors approved policy guidelines for clearing the Bank Group arrears of Heavily Indebted Poor Countries (HIPC) emerging from conflict.¹ These policy guidelines provide a detailed framework and a mechanism to enable qualifying post-conflict countries (PCCs) to clear arrears accumulated to the Bank Group as part of a coordinated re-engagement program with the International Financial Institutions (IFIs) and the international community. Clearing IFI arrears is a precondition for PCCs to qualify for debt relief under the HIPC initiative.
2. The policy guidelines stipulate that arrears clearance programs for PCCs must conform to four guiding principles. First, clearance of arrears must create an opportunity for a sustainable normalization of relations with the Bank Group. Second, arrears clearance programs should demonstrate additionality by building a bridge to follow-up assistance programs that lead to positive net transfers to the countries. Third, arrears clearance programs should be conceived flexibly on a case-by-case basis in close cooperation with other IFIs and the Donor community. Fourth, arrears clearance programs must comply with other key financial policies and practices of the Bank Group.
3. The purpose of this paper is to propose a specific arrears clearance program for Liberia under the Bank Group's general guidelines. This proposal was discussed with the Liberian Authorities, and was reviewed by the Arrears Clearance Working Group (ACWG) and the Post-Conflict Steering Committee (PCSC). Arrears clearance is only one element in Bank re-engagement in Liberia, as set out in the Joint (World Bank-ADB) Interim Strategy Note (JISN) for Liberia² which was approved in September 2007 for the period of July 2007 to June 2008. A multi-year Joint Assistance Strategy will be prepared following arrears clearance.

II. CONTEXT OF RE-ENGAGEMENT

4. This section reviews the context for the proposed arrears clearance program and the overall re-engagement program for Liberia. A more detailed analysis of the Bank Group's re-engagement program is presented in the JISN.

The Socio-Economic Context and Progress in Resolving the Conflict

5. In August 2003, a Comprehensive Peace Agreement (CPA) was signed in Accra, Ghana by the major warring factions in Liberia, after a prolonged cycle of civil conflict. The National Transitional Legislative Assembly (NTLA) with representation from each of the various factions was established in mid-October 2003 with a two-year mandate. During this period, a large United Nations peacekeeping mission, (United Nations Mission In Liberia, UNMIL) was mandated by the Security Council under the UN charter, Article 7 to oversee security, humanitarian relief effort, and initial efforts at reconstruction. Historic presidential elections took place in October-November 2005, and were judged free and fair by international observers. Ellen Johnson-Sirleaf became the first female Head of State in Africa when she was sworn into office on January 16, 2006.

¹ Board Documents, Ref - ADB/BD/WP/2003/147/Rev.1/Approval/Add.1 and ADF/BD/WP/2003/184/Rev.1/Approval/Add.1

² I-CSP, Board Documents, Ref – ADB/BD/WP/2007/77 and ADF/BD/WP/2007/51.

6. More than two decades of civil strife has had a devastating impact on socio-economic development in Liberia, with loss of life and displacement of large swaths of the population, destruction of social and economic infrastructure, disruption of economic activities in urban and rural areas, and deterioration of social and economic indicators. Socio-economic welfare declined along with per capita income, from USD 1,269 in 1980 to USD 163 in 2005. A recent survey conducted by the UNDP using the poverty line of one dollar a day shows that 86 percent of rural households are considered poor, and 64 percent live in severe poverty.
7. With the return of peace, the Liberian government has embarked on a broad-ranging program of reconstruction and reform with support from development partners. The Government, through its 150-Day Plan, implemented short term reforms and deliverables in the four priority areas of Security, Economic Revitalization, Basic Services and Infrastructure, and Governance and Rule of Law. The country has recently completed an Interim Poverty Reduction Strategy Paper (I-PRSP) in consultation with civil society and its development partners. The I-PRSP focuses on the same priorities identified under the 150-Day Plan. A full PRSP is expected to be finalized by mid-2008.
8. Liberia's progress has created optimism within the international community that the country has an opportunity to build a new Liberia based on democracy, transparency, accountability, and economic opportunity for all.

Reengagement of the International Donor Community

International Donor Coordination

9. The international donor community has worked collectively to coordinate re-engagement efforts in Liberia, intensifying their efforts after the signing of the Comprehensive Peace Accord in August 2003. A donors' conference was held in February 2004 and garnered pledges of USD 500 million towards the reconstruction of Liberia.
10. At more recent meeting in February 2007, donors praised Government's economic reform efforts, with the BWIs confirming that Liberia had met all quantitative and structural targets under its latest Staff Monitored Program (SMP). Donors also applauded Liberia's efforts to improve transparency and governance, and urged the country to deepen reforms. Participants discussed Liberia's I-PRSP and the country's external debt situation and arrears clearance.

Multilateral donors

11. *The International Monetary Fund.* The IMF has focused its interventions in the following important areas: (i) supporting the design and implementation of GEMAP; (ii) implementing the Fund's medium term program in Liberia; (iii) guiding the preparation of the I-PRSP and the full PRSP; (iv) designing policies for the medium-term fiscal framework; and (v) guiding monetary policy, bank restructuring, and statistical and measurement issues relating to monetary aggregates, balance of payments, and inflation. The IMF has also provided technical assistance in the area of revenue administration. With the Government of Liberia, the IMF has implemented a Staff Monitored Program since February 2007. They are now in negotiations on the frameworks for a PRGF and EFF (for a combined total likely to exceed 500 million SDR) in support of the country's reform agenda defined in the I-PRSP.

12. *The World Bank.* Starting in 2004, the World Bank supported Liberia through a Results Focused Transition Framework, which had as its primary goals rapid socio-economic revival through labor-intensive infrastructure rehabilitation and community-driven development; establishment of the state and basic economic governance; and establishment of a multi-donor implementation and monitoring mechanism. As of November 2007, the World Bank had granted USD 140 million through its LICUS Trust Fund and IDA pre-arrears clearance grants. The existing portfolio includes USD 68 million in infrastructure projects; USD 58 million in community empowerment and basic services projects; USD 13.3 million in governance and economic revitalization activities and USD 1.4 million supporting donor coordination. The World Bank has also provided advisory services for the preparation of Liberia's I-PRSP.
13. *The United Nations* The UN returned and re-engaged with Liberia in 2003, with representation by the following agencies: FAO, UNDP, UNEP, UNESCO, UNFPA, UN-HABITAT, UNHCHR, UNICEF, UNIFEM, UNOPS, WFP and WHO, in addition to the peacekeeping operation, UNMIL. Between 2004 and 2006, these agencies provided nearly USD 1.0 billion in security and development support to Liberia. Ongoing efforts have focused primarily on: (i) economic recovery, governance and the rule of law; (ii) provision of security, crisis prevention and reconstruction including demobilization, disarmament and reinsertion; (iii) environmental awareness; (iv) education, health, HIV/AIDS prevention; and (v) agriculture.
14. *The European Commission (EC).* In the aftermath of Liberia's conflicts, the EC's involvement in the country was primarily in the form of humanitarian aid financed by the EC Humanitarian Aid Office focusing on coordination, health and nutrition, education, protection and water and sanitation. As of end-2006, a total of about USD 62 million of assistance has been given to Liberia.

Bilateral donors

15. *The United States of America.* American support for Liberia targets five areas: (i) agriculture and food security; (ii) coordination, governance, the rule of law, peacekeeping and protection (iii) social sectors, including public health and education, HIV/AIDS, refugees; (iv) infrastructure and water and sanitation; and (v) multi-sectoral activities. Between 2004 and 2006, the United States have provided aid totaling about USD 1.3 billion to Liberia, plus debt forgiveness of USD 405 million.
16. *Nigeria.* A pivotal role was played by Nigeria in negotiating peace in Liberia. Nigeria has since contributed significantly to peacekeeping initiatives in the country by sending troops and logistical assistance. Nigeria also provided a safe haven for the former President of Liberia Charles Taylor when he was exiled to pave the way for the negotiation of the Comprehensive Peace Agreement. The Nigerian Authorities continue to demonstrate strong solidarity with Liberia and to support the country's reconstruction efforts, including through participation in arrears clearance to the Bank Group.
17. Other bilateral donors that have provided humanitarian or development assistance directly or through UN agencies include Germany, Japan, Norway, Sweden, Switzerland, Denmark, Irish Aid, Canada and Spain. Germany has written-off Liberia's arrears of USD 313 million.

Activities of the African Development Bank Group

18. The Bank has maintained a strong dialogue with Liberia on arrears clearance and development priorities. In 2004, a presentation was made to the Liberian authorities and donors on arrears clearance using the Bank's PCCF mechanism. In 2005, a possible financing arrangement for clearing Liberia's arrears was agreed with Government. The Bank also participated in Joint IMF/World Bank Debt Sustainability Analysis missions to Liberia in 2006 and 2007. In 2006, the Bank's Executive Boards approved a Country Dialogue Paper for Liberia, focusing on arrears clearance, institutional capacity building and infrastructure rehabilitation. An Economic Management and Poverty Reduction project amounting to UA 3 million was approved as a pre-arrears clearance operation. Nordic Trust Funds have also been committed to fund a Governance Reform Program and a forestry sector component of Liberia's Extractive Industry Transparency Initiative. In September 2007, the Board approved a Joint ADB-World Bank Interim Strategy Note for Liberia.

Arrears Clearance Efforts

19. In addition to the ADB, Liberia is in the process of clearing arrears to other IFIs. Arrears to the World Bank totaling USD 388.0 million were cleared on December 5, 2007, with financing from a USD 416.4 million Reengagement and Reform Support Program grant. The IMF arrears clearance operation is expected to take place in January 2008. Successful completion of these operations will pave the way for re-engagement of the country with the international community and will facilitate HIPC access. Remaining arrears to commercial creditors and bilateral lenders will also need to be addressed progressively.

Commercial Creditors

20. Most of Liberia's debt records were destroyed through lootings and fire at the Ministry of Finance. International financial advisors, financed by Swiss Cooperation, are trying to reconcile Liberia's external commercial debt, despite considerable difficulties. Thus far, Liberia's external commercial debt is estimated to be between USD 1.1-1.6 billion, and much of it is in the hands of secondary creditors. The Government has stated that in addressing commercial debt it will (i) seek a comprehensive solution to its commercial debt problem, (ii) provide comparable treatment to all creditors (bilateral and commercial), (iii) conduct itself in a transparent and cooperative manner, (iv) abide by the procedures established under the HIPC Initiative, and (v) adhere to the policies regarding the use of funds of donors that will support the resolution of Liberia's commercial debt.

Paris Club

21. Liberia's estimated bilateral debt stands at about USD 1.4 billion. A total of USD 405 million in debt to the United States and USD 314 million in debt to Germany has already been forgiven. The remaining debt is owed to other Paris Club members. Government intends to seek debt forgiveness on Cologne terms.

Domestic Creditors

22. As of January 2007, of the estimated domestic outstanding claims of USD 914 million, much is contested, with only about a third considered valid. Of the valid debt, about a third is to the

banking system, including the Central Bank of Liberia, and there are significant arrears on payments to suppliers of goods and works. A resolution strategy for domestic debt has been developed that aims to settle salary arrears and most vendor arrears before end-2008. The government began implementing the strategy and settling supplier arrears in 2007.

HIPC Debt Relief Prospects

23. Liberia is one of the most heavily indebted countries in the world and the country's long-term financial sustainability is predicated on substantial debt relief under the enhanced HIPC initiative. At year-end of June 2007, Liberia's total external debt including capitalized interest and penalties stood at roughly USD 4.6 billion, which is equivalent to 2094% of exports of goods and services, well above the benchmarks for debt sustainability of 150%³. Liberia's ratio of debt service to exports of goods and services is projected at 147% by the end of 2007, far above the HIPC threshold of 20%⁴, a serious impediment to the country's development. As a result, gaining access to debt relief under the HIPC and MDRI initiatives is a critical component of the government's strategy. So far Liberia has established a strong track record of reform that meets the requirements for reaching the HIPC decision point. It is expected that as soon as arrears to preferred creditors are cleared, Liberia will proceed to the HIPC decision point (as early as February 2008) and then begin to receive interim debt relief. Liberia's remaining debt to preferred creditors will qualify for full cancellation under the MDRI once Liberia reaches the HIPC completion point, which is currently expected by mid-2010.

III. COUNTRY QUALIFICATION

24. This section reviews the basis for proposing an arrears clearance program for Liberia under the Bank Group's PCC arrears clearance guidelines. It begins by examining the justification for designating Liberia as a PCC. It then demonstrates that Liberia has adequately fulfilled the additional requirements to be eligible for an arrears clearance program and partial financing from the Bank Group's PCCF.

Designation as a Post-Conflict Country

25. Designation as a PCC to qualify for an arrears clearance program is determined on a case-by-case basis, taking into consideration a broad menu of factors and country specificities. The Bank Group's policy guidelines for PCCs identify five key factors that are used to define the Bank Group's approach to post-conflict designation as discussed below.⁵

i. The Level of Peace

26. The peace and security situation in the country has improved considerably since the signing of the Comprehensive Peace Agreement in Accra in August 2003 and the prospects for lasting peace are very good. Key actions that have helped deepen peace in the country are: (i) the successful completion of fair and free legislative and presidential elections in October-November 2005; (ii) the establishment of the Truth and Reconciliation Commission to foster reconciliation within and between Liberia's polarized communities (iii) rejuvenated

³ Annex 3 presents an overview of the composition of the country's external debt.

⁴ Based on Liberia's 2007 Country Policy and Institutional Assessment (CPIA) rating of 3.27.

⁵ Board Documents, Ref - ADB/BD/WP/2003/147/Rev.1/Approval/Add.1 and ADF/BD/WP/2003/184/Rev.1/Approval/Add.1, Annex 1, paragraph 5

Governance Reform Commission (GRC) that is restoring and reforming government institutions to ensure participatory democracy; (iv) the establishment of the Independent National Commission on Human Rights to promote human, economic, social and cultural rights; and (v) over 20 national NGOs focusing on peace-building initiatives.

ii. *Quality of Governance*

27. Liberia has made significant progress in improving political, institutional and economic governance with the implementation of GEMAP, a Security Council-backed framework aiming to improve governance. It has six key components: (i) financial management and accountability; (ii) improving budgeting and expenditure management; (iii) securing Liberia's revenue base; (iv) improving procurement practices and the granting of concessions; (v) establishing effective processes to control corruption; and (vi) supporting key institutions and capacity building. The Government has also subscribed to the Extractive Industries Transparency Initiative and has started work on implementing the Kimberley Process. Efforts are also underway to create an effective Supreme Audit Agency by ensuring the legal independence, and strengthening the capacities, of the Government Audit Committee .

iii. *Resumption of Economic Activity*

28. Steady progress in re-establishing peace and security in Liberia has allowed economic activity to resume in recent years. After having declined by over 30 percent in 2003, real GDP growth is estimated to have increased from 2.6 percent in 2004, to 5.3 percent in 2005 and to 7.8 percent in 2006, reflecting the gradual improvement in security in rural areas, post-civil war construction, and notably the large donor presence in the services sector. Liberia's macroeconomic outlook is positive, with real GDP growth forecast at 9.4% in 2007 and 9.5% in 2008, and inflation kept at single digits. Detailed information about Liberia's economic recovery is documented in the JISN.

iv. *Progress in Resettlement, Disarmament and Reintegration*

29. The United Nations Development Programme has been the primary supporter of Demobilization, Disarmament and Reinsertion (DDR) efforts in Liberia, supervised by the UNMIL, and estimated to have disarmed and demobilized 101,495 fighters. So far, 75,000 of the former fighters have been placed in donor-funded training programs, with another 3,500 enrolled in programs that are yet to start. An estimated 23,000 ex-combatants are yet to be re-integrated into society. This remains the biggest challenge for the National Commission on Disarmament, Demobilization, Rehabilitation and Re-integration which has now taken over the operation from UNMIL.

v. *Assessment and Opinion of the IFIs*

30. The IMF has designated Liberia as a post-conflict country and the World Bank considers Liberia within its group of LICUS countries within their respective policy frameworks.

31. On the basis of substantive progress with respect to these factors, Management has formally designated Liberia as a post-conflict country under the Bank Group's policy guidelines.

Eligibility for an Arrears Clearance Program

32. In addition to designation as a PCC, the Bank Group's policy guidelines enumerate six criteria for a PCC to benefit from an arrears clearance program and to qualify for financial assistance from the PCCF as discussed below.⁶

i. HIPC Eligibility

33. The Bank Group's policy guidelines specify that only HIPC countries that have not yet reached decision point shall be eligible for assistance through an arrears clearance program. Liberia is eligible for debt relief under the enhanced HIPC initiative, but has not yet reached the decision point. More specifically, Liberia has been identified as a post-conflict HIPC-eligible country.⁷ As such, Liberia should benefit from additional flexibility in terms of the length and content of the macroeconomic stability requirement, as well as the timing and scale of HIPC relief after reaching decision point. The IMF has agreed to fast-track Liberia to the HIPC decision point as early as February 2008, based on the country's satisfactory progress in implementing policies under the current Staff Monitoring Program.

ii. Coordinated Re-engagement Process

34. The Bank Group's policy guidelines specify that arrears clearance programs will only be undertaken in the context of coordinated re-engagement with other development partners. The Accra Comprehensive Peace Accord is overseen by the International Contact Group on Liberia, co-chaired by European Commission (EC) and ECOWAS. GEMAP is a cooperative response to the pervasive governance failures in the country, and was initiated by the Bank, the World Bank, the IMF, the EC and ECOWAS. International partners meet regularly in Monrovia to discuss progress in strategy implementation and assess tangible results. The Bank does not currently have a field office in Liberia, but the recent collaboration with the World Bank on a Joint Interim Strategy Note is another example of ongoing coordination efforts among donors.

iii. Non-Discriminatory Debt Servicing

35. The Bank Group's policy guidelines specify that arrears clearance programs shall only be undertaken when the beneficiary PCC demonstrates non-discriminatory servicing of Bank Group debt relative to debt to other preferred creditors. Since December 2005, Liberia has been making proportional and non-discriminatory token payments to the IMF, the World Bank and the Bank of USD 60,000, USD 25,000 and USD 15,000 per month respectively. Although these payments are not enough to stabilize the country's stock of arrears, they have demonstrated the country's strong commitment and willingness to address its debt servicing issue. A more detailed analysis of Liberia's debt service track record with the Bank Group is presented in Annex 1.

⁶ Board Documents, Ref - ADB/BD/WP/2003/147/Rev.1/Approval/Add.1 and ADF/BD/WP/2003/184/Rev.1/Approval/Add.1, page 7

⁷ For details, see IMF/World Bank, Assistance to Post-Conflict Countries and the HIPC Framework, 2001.

iv. Financial Sustainability

36. The Bank Group's policy guidelines call for arrears clearance programs that contribute to the long-term financial sustainability of the beneficiary country. Clear evidence of an adequate financing plan that enables the country to reach the HIPC decision point without undue risk of falling back into arrears should be presented. Liberia's high level of debt service is a major handicap and maintaining financial sustainability will be a challenge, particularly in the near term. For this reason, maturities falling due in fiscal year 2008 are included in the stock of arrears to be cleared. Fast tracking the country towards the HIPC decision and completion points will also go a long way to minimize the debt service obligations of the country. Once Liberia reaches the HIPC completion point, the country will benefit from significant full debt relief, facilitating longer-term financial sustainability.

v. Maximum Effort to Pay from Internal Resources

37. The Bank Group's policy guidelines require beneficiary countries to demonstrate a maximum reasonable effort to clear their arrears to the Bank Group. Despite its limited resources, Liberia has already paid a total of UA 248,111 in debt service, and the Bank has received UA 1.62 million towards arrears clearance, representing 1% of total outstanding arrears. Management considers that Liberia's contribution to the proposed arrears clearance operation demonstrates the country's commitment to normalizing relations with the Bank Group.

vi. Maximum Effort to Mobilize Donor Resources

38. The Bank Group's policy guidelines require beneficiary countries to demonstrate a maximum effort to mobilize donor resources to clear Bank Group arrears. Liberia has worked in close collaboration with the Bank Group and other IFIs to solicit the financial assistance of prospective donors. These efforts have been rewarded by donor financial support sufficient to meet the UA 48.2 million donor share of arrears clearance for the Bank Group as detailed in Annex 6, Table 8.
39. On the basis of the foregoing assessment, Management has concluded that Liberia qualifies for the arrears clearance program proposed here.

IV. PROPOSED ARREARS CLEARANCE PROGRAM FOR LIBERIA

40. Liberia began to accumulate chronic arrears to the Bank Group in April 1985. Arrears are projected to reach UA 159.6 million by December 31, 2007. Of this, UA 125.6 million is outstanding to ADB, UA 28.9 to NTF and UA 5.1 million to ADF. Additional maturities to the Bank Group of UA 2.4 million will fall due in 2008, and are included in the arrears clearance proposal to prevent the country falling back into arrears prior to the HIPC decision point.
41. The Bank Group's policy guidelines provide for clearance of arrears according to a three-way burden-sharing arrangement between the country, Donors and the PCCF. The amounts and timing of payments from each party should be structured on a case-by-case basis to reflect the projected resource flows for each PCC, with a preference for clearing arrears and lifting sanctions as quickly as possible.

42. Management is proposing maximum flexibility for Liberia on the cut-off date and burden sharing arrangements for the following reasons: (i) an extremely heavy and unsustainable debt burden, with total external debt exceeding USD 4.6 billion, a NPV of debt/exports of goods and services of 2094%, and a debt service to exports ratio of 147%, far exceeding the HIPC thresholds; (ii) huge arrears—arrears as a percentage of revenues are about 1050%; (iii) a severe cash flow constraint—total revenue is projected at only USD 183 million in 2007/2008, translating into spending per capita of only about USD 25, one of the lowest levels in the world; and (iv) extreme poverty with two-thirds of the population living below one dollar a day. Management is proposing a financing plan that calls for the following contributions: 1% from Liberia, 29.7% from donors, and 69.3% from the PCCF. On December 17, 2007, Liberia paid in UA 1.62 million, thereby meeting its arrears clearance financing obligations.
43. Donor contributions are presented in Table 8, Annex 6. At end-October 2007 exchange rates, donor contributions were sufficient to meet the donor share of UA 48.3 million, representing 29.7% of the total stock of arrears at December 31, 2007. Management is proposing a UA 113 million grant from the Bank Group’s PCCF to complete the financing plan for Liberia’s arrears clearance program. The proposed UA 113 million from the PCCF represents 69.3% of Liberia’s total stock of arrears at December 31, 2007. The proposed financing plan is summarized below.

Table 1 **Arrears Clearance Financing Plan**
(UA Millions)

Source	Amount	Share
Liberia	1.62	1%
Donors	48.24	29.7%
PCCF	112.55	69.3%
Total	162.41	100%

44. The Bank Group’s policy guidelines expressly prohibit operations that could be construed as “refinancing” or “round-tripping.” The financing plan for Liberia’s arrears clearance program has been structured to comply with this prohibition. Liberia’s arrears are almost exclusively to the ADB window and the country’s payments will be applied to ADB arrears. As presented in Annex 6, the Bank Group’s contribution will be drawn from the PCCF resources in the segregated account for the ADF.⁸ These resources will be used exclusively to clear arrears to the ADB. Donor resources will be used to clear NTF arrears and residual arrears to the ADB and the ADF.

Implementation Plan

45. Implementation of Liberia’s arrears clearance plan would start with approval of this proposal by the Boards of Directors of the Bank Group. Following approval, GECL will prepare protocol agreements for the PCCF grant, to be signed by the Government of Liberia and the Bank Group institutions. In line with policy guidelines, sanctions on Liberia would be lifted upon formal receipt of irrevocable financing commitments from donors.

⁸ The ADF segregated account within the PCCF has been initially financed through UA 250 million from ADF-X. Out of this, UA 100 million has been committed, while the remaining UA 150 million is a supplementary amount to be used as needed.

Outlook for Resumed ADF Lending Activities and Positive Transfers

46. ADB assistance to Liberia under the JISN will be provided within the framework of ADF-10 (2005-2007) and part of ADF-11 (2008-2010). ADB support will be selective, focusing on the priority sectors of infrastructure and governance. The country allocation to Liberia under ADF-10 amounted to UA 18 million. UA 3 million was allocated towards the Institutional Support Project (ISP) as pre-arrears clearance support, approved by the ADF Board in October 2006. The balance of UA 15 million will be used to fund a Labor-based Public Works project in support of the government's National Public Works Program. This project is submitted for Board approval in parallel to this proposal. Its main objective is the rehabilitation of the Fish Town - Harper Road segment, enhancing mobility and accessibility to the country's interior. The project will create permanent and temporary job opportunities through the use of labor-based methods, and increase the skills of workers in local communities.

47. The Bank Group has a robust pipeline of projects for 2008 to continue support to infrastructure and governance. Prior to completion of the JISN in June 2008, the Bank Group will prepare a full Country Strategy Paper (CSP) for Liberia, covering the period mid-2008 to 2011, based on the government's full PRSP. The CSP will govern use of resources to Liberia under ADF-11 and part of ADF-12 as well as exceptional post-conflict allocations from the Fragile States Facility. With approval of the Labor-based Public Works Project, the Bank will fulfill its goal of providing net positive transfers to Liberia. It will continue to provide new resources estimated at a minimum of USD 12 million per annum in coming years. Annex 5, Table 6b presents the potential impact of HIPC debt relief on Liberia's projected Bank Group debt service. Given the substantial reduction in Bank Group debt servicing from potential HIPC debt relief, providing positive net transfers to Liberia will be significantly easier after the country reaches the decision point.

48. By clearing arrears and normalizing relations with the Bank Group, Liberia would realize significant benefits, including: (i) UA 161.2 million in grant financing towards arrears clearance from the PCCF and Donors; (ii) renewed access to Bank Group assistance as detailed above; (iii) an important step toward IMF approval of both a PRGF and EFF totaling more than 500 million SDR; and (iv) satisfaction of one of the enhanced HIPC initiative qualification criteria allowing Liberia to reach the decision point and benefit from significant interim debt relief. The value of the last two benefits cannot be overstated, as good standing with respect to these two programs is critical to Liberia's near-term and long-term economic outlook.

V. CONCLUSIONS AND RECOMMENDATIONS

49. After a decade of devastating internal conflict, the prospects for lasting peace in Liberia are encouraging. International support has been, and continues to be, mobilized to help the country consolidate its peace and reconciliation processes. The Liberian Authorities have articulated an economic reform program that is being implemented with the support of its development partners. Liberia's commendable progress has created an opportunity for the

Bank Group to use its PCCF arrears clearance framework to assist Liberia in clearing its remaining arrears and normalize relations with the Bank Group.

50. Management believes that Liberia has satisfied all of the criteria required under the Bank Group's policy guidelines to qualify for an arrears clearance program and financial assistance from the PCCF. Liberia has made a significant effort to pay its share of outstanding arrears to the Bank Group, through a contribution of UA 1.62 million equal to one percent of outstanding arrears. Liberia has also worked closely with the Bank Group to mobilize UA 48.4 million from donors in support of the proposed arrears clearance program. An allocation of UA 113 million from the PCCF would complete the financing plan.
51. In light of the above assessment:
 - i. the Boards of Directors are invited to endorse the assessment that Liberia, as a PCC, has satisfied all the criteria required to qualify for financial assistance from the PCCF;
 - ii. the Boards of Directors are invited to approve, in accordance with PCCF policy guidelines, the specific flexibilities required for Liberia's financial circumstances, namely to limit the country's share to a one percent contribution, extend the initial cut-off date of end-December 2003 to end-December 2007 and include in the financing plan the servicing of maturities through end-2008 to prevent reoccurrence of arrears prior to reaching the HIPC decision point;
 - iii. the ADF Board of Directors is invited to approve a grant of UA 113 million from the PCCF for the proposed arrears clearance program for Liberia; and
 - iv. the Boards of Directors are invited to approve the lifting of sanctions on Liberia upon receipt by the ADF of instruments, acceptable to the ADF, evidencing Donors' irrevocable financial commitments.

ANNEX 2
Liberia's Resource Outlook

1. Table 3 below presents the key elements of Liberia's fiscal framework from 2002/03 to 2009/10. Liberia will need to solicit concessional funds from donors to meet future debt servicing and arrears clearance obligations over the forecast period. Interim and final debt relief stemming from HIPC and MDRI in the projection period will substantially reduce this burden, leading to sustainable re-engagement by the Bank Group in the country.

Table 3 **Overview of Fiscal Framework, 2002/03 to 2009/10**

	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
					Est.	Proj.	Proj.	Proj.
Millions of U.S. dollars								
Total Revenue and Grants	56.6	59.0	80.3	85.6	148.3	182.5	197.1	234.8
Total Revenue	56.6	56.0	79.3	84.6	146.8	182.5	191.1	227.7
Tax Revenue	48.5	55.3	75.7	81.0	138.9	147.1	163.3	190.9
Non-tax Revenue	8.1	0.8	3.6	3.6	8.0	35.4	27.8	36.8
Grants	0.0	3.0	1.0	1.0	1.5	0.0	6.0	7.1
Total expenditures	69.2	50.6	76.3	59.6	134.7	179.0	189.9	225.9
Current expenditures	28.3	46.9	65.7	56.0	117.4	158.7	170.3	193.5
Wages and salaries	13.1	24.3	42.3	29.4	32.7	63.5	72.3	83.7
Goods and services	5.9	15.8	16.0	15.4	33.4	53.4	55.9	66.7
Interest on debt	8.8	2.8	1.4	1.4	13.7	13.7	12.3	12.2
Domestic arrears clearance *	0.0	0.0	0.0	7.5	0.0	0.8	7.2	9.0
Subsidies, transfers	0.6	0.0	6.0	9.8	17.3	28.6	29.8	31.0
Capital expenditures	40.9	3.7	10.6	3.7	17.2	20.4	19.6	32.3
Percent of GDP								
Total revenue and grants	11.9	13.6	16.2	15.1	23.3	26.0	24.7	25.4
Revenue	11.9	12.9	16.0	14.9	22.9	26.0	23.9	24.6
Grants	0.0	0.2	0.2	0.2	0.4	0.0	0.8	0.8
Total expenditure and net lending								
Current expenditure	5.9	10.8	15.4	9.9	18.2	25.5	23.8	24.4
Capital expenditure	8.6	0.9	2.1	0.6	2.4	2.9	2.5	3.5
Overall surplus/deficit (incl. grants)	-2.6	1.9	0.8	4.6	2.7	0.5	0.9	1.0

* Includes accumulation in domestic debt trust fund

Source: IMF

ANNEX 3
Liberia's External Debt Structure

1. Table 4 below presents the composition of Liberia's external public debt, including outstanding loan balances and arrears at end-June 2007. The country's bulk of the debt is with Multilateral lenders (35%) and Commercial lenders (35%). Paris Club and Bilateral Creditors account for 30% of total external public debt.

Table 4 **Liberia's External Public Debt Structure**
(In USD million, except where noted)

Multilateral Institutions:		US\$1.6 billion	
o/w	IMF		\$809 million
	WB		\$443 million
	AfDB		\$271 million
Bilateral:		US\$1.4 billion	
	Paris Club:	\$1.3 billion	
o/w	United States		\$421 million
	Germany		\$321 million
	Non-Paris Club:	\$127 million	
Commercial:		\$1.6 billion	(indicative)
o/w	supplier credit	\$ 384 million	
TOTAL		\$ 4.6 billion	

ANNEX 4
Liberia's Arrears to the Bank Group

1. Table 5a below presents the composition of Liberia's arrears to the Bank Group at October 31, 2007 and December 31, 2007 compared to December 31, 2003. During this period, Liberia's arrears increased by UA 22.43m.

Table 5a **Evolution of Liberia's Arrears Since December 31, 2003***
(UA Millions**)

	December 31, 2003	October 31, 2007	December 31, 2007
ADB	112.7	125.6	125.6
ADF	3.0	5.1	5.1
NTF	21.5	28.9	28.9
Total	137.2	159.6	159.6

Source: Bank Group (FFCO).

* Some totals may not add up due to rounding.

** Based on October 31, 2007 exchange rates.

2. Table 5b below presents the composition of Liberia's arrears to the Bank Group at October 31, 2007. Principal in arrears represented 65% of total arrears while charges represented the remaining 35%. Liberia's total arrears to the Bank Group are in majority to the ADB window (79%), with a smaller portion to NTF (18%), while arrears to the ADF window accounting for just 3%.

Table 5b **Composition of Liberia's Arrears by Window at December 31, 2007***
(UA Millions**)

	Principal	Charges	Total
ADB	87.1	38.5	125.6
ADF	1.8	3.3	5.1
NTF	14.8	14.1	28.9
Total	103.7	56.0	159.6

Source: Bank Group (FFCO).

* Some totals may not add up due to rounding.

** Based on October 31, 2007 exchange rates.

3. Table 5c below presents the currency composition of Liberia's arrears to the Bank Group at December 31, 2007. USD-denominated arrears represent 60% of total arrears while JPY-denominated arrears represent 17% and arrears denominated in other currencies represent the remaining 23%.

Table 5c **Currency Composition of Liberia's Arrears at December 31, 2007***
(UA Millions**)

	USD	JPY	CHF	EUR	Other	Total
ADB	63.0	27.0	17.6	17.4	0.5	125.6
ADF	3.9	0.7	-	0.1	0.4	5.1
NTF	28.9	-	-	-	-	28.9
Total	95.8	27.8	17.6	17.5	0.9	159.6

Source: Bank Group (FFCO).

* Some totals do not add up due to rounding.

** Based on October 31, 2007 exchange rates.

ANNEX 5
Liberia's Future Debt Service to the Bank Group

1. Table 6a below presents Liberia's projected debt service due to the Bank Group in 2008 to 2010. These projections are based on exchange rates prevailing on October 31, 2007.

Table 6a **Projected Bank Group Debt Service***
(UA Millions**)

	January 1, 2008	July 1, 2008	January 1, 2009	July 1, 2009	January 1, 2010	July 1, 2010	Total
ADB	0.04	-	-	-	-	-	0.04
ADF	0.29	0.29	0.29	0.28	0.28	0.28	1.71
NTF	0.92	0.88	0.88	0.86	0.86	0.84	5.24
Total	1.26	1.17	1.16	1.14	1.14	1.12	6.99

Source: Bank Group (FFCO).

* Some totals may not add up due to rounding.

** Based on October 31, 2007 exchange rates.

2. Table 6b below presents the potential impact of HIPC debt relief on Liberia's projected Bank Group debt service. These projections assume a common reduction factor of 92% and that Liberia reaches the HIPC decision point before December 2008. Given the substantial reduction in Bank Group debt servicing from potential HIPC relief, providing net positive transfers to Liberia would be significantly easier after the country reaches decision point.

Table 6b **Projected Debt Service to the Bank Group with HIPC Relief**
(UA Millions*)

	2009	2010	2011	2012	2013	2014	2015
Debt service before HIPC	2.31	2.26	2.22	2.18	2.14	2.09	1.39
Bank Group debt relief	2.12	2.08	2.04	2.01	1.96	1.93	1.28
Debt service after HIPC	0.18	0.18	0.18	0.18	0.18	0.18	0.18

Source: Bank Group (FFCO & PPLB).

* Based on September 30, 2004 exchange rates.

** Does not include debt servicing payments of UA 9.2 million due in the first semester of 2005.

Liberia's Arrears Clearance Financing Plan

1. Table 7 below presents a summary of the financing plan for Liberia's proposed arrears clearance program. The amount to finance is the sum of the projected arrears at December 31, 2007 and the 2008 maturities, so that the country does not relapse into arrears.
2. The top row presents the expected sources of financing starting with: the Bank Group's Post-Conflict Country Facility (PCCF); payments received from Liberia; and Donor contributions.
3. The lower half of the table presents the expected uses of funds within the financing plan. In accordance with the Bank Group's policies prohibiting refinancing, PCCF resources will come from the ADF segregated account and will be used to clear ADB arrears. Liberia's arrears clearance payments were used to clear ADB arrears. Donor contributions will be used to clear the remaining ADB arrears and the ADF arrears. There are no prohibitions or restrictions on the use of Donor contributions.

Table 7 **Arrears Clearance Financing Plan**
(UA Millions*)

Sources	PCCF ADB 1	PCCF ADF 2	PCCF NTF 3	Total PCCF 4=1+2+3	Liberia 5	Donors 6	Total 7=4+5+6
Total Sources	15.36	96.94	0.00	112.29	1.62	48.13	162.04
ADB Arrears		81.58	0.00	81.58	0	44.04	125.62
ADF Arrears	0		0.00	0.00	1.62	4.08	5.70
NTF Arrears	15.36	15.36		30.72	0.00	0.00	30.72
Total Uses	15.36	96.94	0.00	112.29	1.62	48.13	162.04

Source: Bank Group (FFMA).

* Based on October 31, 2007 exchange rates.

4. Table 8 below presents the expected Donor contributions to the arrears clearance financing plan for Liberia. Donor pledges made in other currencies have been expressed in UA based on October 31, 2007 exchange rates.

Table 8 Donor Contributions to Financing Plan
(Millions of Currency Units)

Donor	Amount	Amount (UA m)*	Payment Date	Conditions	Status
U.S.A.	USD 15m	9.5		None	Pledged
European Commission	EUR 10m	9.2		Disbursement at HIPC DP	Written Confirmation Pending
Nigeria	USD 13m	8.3		Ratification	Pledged
Germany	EUR 7m	6.4		None	Disbursed
U.K.	10% of Donor portion	4.8		None	Pledged
Canada	USD 4.8m	3.0			Written Confirmation Pending
Norway	USD 3.76m	2.4		None	Disbursed
South Africa	USD 3.6m	2.3		None	Disbursed
Sweden	USD 3.45m	2.2			Written Confirmation Pending
Switzerland	USD 3m	1.9			Pledged
Finland	EUR 0.8m	0.7			Pledged
Denmark	DKK 4.1m	0.5			Pledged
Total		51.2			

Source: Bank Group (FFMA).

* Based on October 31, 2007 exchange rates.