

## International Monetary Fund

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### **Liberia:** Letter of Intent

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September 12, 2006

Mr. Rodrigo de Rato  
Managing Director  
International Monetary Fund  
Washington, D.C. 20431  
USA

Dear Mr. de Rato:

1. We would like to take this opportunity to inform you of our progress in implementing Liberia's staff-monitored program (SMP) that was agreed with IMF staff in February and approved by you in April. You will recall that, after decades of mismanagement and internal conflict that have left the Liberian economy in ruins and the vast majority of the population desperately poor, the SMP's key objectives are to rebuild public institutions, restore credible financial management, and accelerate structural reforms to bring hope and confidence back to the country. To this end, the program is based on ambitious macroeconomic policy and structural reform targets.

2. We believe we have made good progress in implementing our economic program, notwithstanding even more serious capacity constraints than we foresaw in the first weeks of the new administration and the need to reach agreement with the opposition-led legislature on some key measures. We have greatly strengthened fiscal management and made significant advances on our structural reform agenda. The SMP's quantitative benchmarks through end-June were met (Table 1A), as were most of the structural benchmarks, with some encountering temporary delays (Table 2). We are taking corrective action to ensure that these benchmarks are also met. As stipulated under the SMP, we submitted a balanced budget proposal for the 2006/07 fiscal year to the legislature on June 29. The legislature approved the budget on August 22.

3. This critical break with the past and our resolute commitment to push our reform agenda ahead with the support of the international community offer the promise of sustained growth for Liberia over the medium term and the alleviation of the suffering of the Liberian people going forward.

4. Since February, revenue performance has improved dramatically, due, in part, to the more comprehensive implementation of pre-shipment inspections of all imports and exports, a strengthening of the Large Tax Payer Unit (LTU) (a benchmark for end-March), and the elimination of noncash methods for the settlement of tax obligations. Overall, revenues for the period February-June 2006 rose 18 percent over the corresponding period the year before, and exceeded the program floor by a comfortable margin. While the number of tax payers

covered by the LTU fell short of the end-June benchmark, we are in the process of auditing a number of companies and expect to meet the target by end-September 2006. We recognize, however, that a reorganization and further strengthening of the LTU is needed and, following an audit of the unit by the Auditor General, are now considering additional changes in the broader context of a review of revenue administration on the basis of technical assistance from the Fiscal Affairs Department of the IMF.

5. We also developed a strategy to deal with overdue tax obligations (a benchmark for end-June). This entailed the identification of businesses with overdue obligations, the amounts involved, the period covered, and reasons for delayed settlement. Notifications for payment have been sent. In the event a business persists in its failure to settle overdue obligations, it will be sent warning notices calling for payment within a reasonable timeframe as allowed by the Liberian Revenue Code, or face closure in line with remedies provided by the Code.

6. In line with our commitment under the SMP to implement a balanced cash-based budget and avoid the accumulation of further domestic arrears, we have strengthened the role of the Cash Management Committee, a crucial element of our commitment control system. This has been achieved by ensuring that the Bureau of the Budget does not make allotments that exceed revenues and that line ministries do not make commitments that exceed their allotments. We have also made a public announcement that, to be valid, all government purchase orders must be stamped with a special seal from the Bureau of General Accounting (a continuous benchmark from end-June). Delays in approval of the recast budget until April and the strict implementation of the new interim financial rules and enforcement of the provisions of the Public Procurement and Concessions Act led to slower than expected expenditure approval during February-April and caused the accumulation of central bank balances in the government's accounts at the Central Bank of Liberia (CBL). In May and June, we were able to execute a large volume of expenditures, bringing overall spending in February-June into line with the recast budget, without breaching the requirements of the commitment control system. In our view, following a number of workshops, the ability to execute spending in June reflects the increased familiarity of line ministries with the proper procedures for submitting expenditure requests. We recognize the importance of prioritized monthly cash plans for keeping expenditures in line with revenues and will, therefore, strictly adhere to them in the 2006/07 fiscal year. We fully expect expenditure plans to be executed in a more timely fashion in the period ahead.

7. Going beyond understandings in the SMP, we have submitted legislation that would prevent the executive from making changes to budget allocations exceeding 30 percent of a ministry's or agency's approved budget without the approval of the legislature. We have also submitted to the legislature draft legislation to allow for the full integration of the Bureau of Budget and the Bureau of Maritime Affairs into the Ministry of Finance. To facilitate the timely approval of the budget, we chose not to submit this legislation to the legislature until after the passage of the 2006/07 budget. However, the intent and spirit of the integration have

been met – in February, the President instructed the heads of these agencies to report directly to the Minister of Finance, thus adhering to the substance of the draft legislation. This has improved budget execution as well as the budget formulation process.

8. The verification of the stock of the government's domestic debt (a benchmark for end-June) has proved to be a more challenging task than we envisaged. We judged it necessary to appoint an interministerial vetting committee to verify smaller claims and selected, through international tender, an external auditor to verify the larger claims. We recognize that the verification of the stock of outstanding claims is a crucial first step toward finalizing our domestic debt resolution strategy by end-September. We are, therefore, pushing for the verification process to be completed as soon as possible. In addition to the verification of smaller claims on the government, the interministerial committee will provide input into the task of designing the domestic debt resolution strategy and developing a debt management policy for the government.

9. Monetary policy has been effective in maintaining inflation in single digits. In view of the high dollarization of the economy, the expansion of the Liberian component of money supply will continue to be limited to maintain a broadly stable exchange rate, while meeting the reserve accumulation targets under the SMP. The CBL has held regular foreign exchange auctions since end-March (a continuous benchmark from end-March), which have contributed to the maintenance of the relative stability of the exchange rate. The foreign exchange market remains the main channel through which monetary impulses affect prices, and the exchange rate continues to be the most meaningful indicator of monetary policy conditions. The monetary policy framework has been improved by clarifying the role of the Money Management and Policy Review Committee (a continuous benchmark from end-March) and the posting of the final monetary policy framework paper on the CBL website (a benchmark for end-March) in March. Financial management at the CBL has been strengthened significantly, and the CBL will continue to target a balanced cash-based budget in line with its commitment under the SMP. Moreover, a financial restructuring plan for the CBL will be completed by end-September 2006, while an external audit of the CBL ( a benchmark for end-September) will be undertaken in early October. We have also requested a voluntary safeguards assessment in anticipation of a Fund-supported program.

10. We have taken important steps to improve governance that are consistent with the donor-supported Governance and Economic Management Assistance Program (GEMAP) and the SMP. In particular, internationally recruited experts with co-signatory authority have been placed at the main revenue generating agencies and a Fund-recruited expert, working under the guidance of the Executive Governor, has been serving as Chief Administrator at the CBL since February. A program for reviewing all concessions, contracts, and licenses granted under the previous transitional government (a benchmark for end-April) was approved by the steering committee of the GEMAP in May. This review, which is now under way, is likely to be completed only by the end of the year, due to delays in appointing internationally recruited experts. We expect, however, that the review of the most important

contracts (e.g. MITTAL Steel and Firestone) will be completed by end-September 2006. A new travel ordinance, incorporating the main recommendations of the ECOWAS-financed audit report, was issued on April 1 (a benchmark for end-March). Substantial progress has been made in developing a national anti-corruption strategy (a benchmark for end-May). A draft anti-corruption policy paper that lays out the main elements of an anti-corruption strategy has been completed and is being reviewed in consultation with donors. Following approval by the President, the EGSC and the LRDC, the strategy will be finalized by end-September 2006. In the meantime, legislative ratification of the anticorruption conventions of the United Nations and African Union have been obtained. The government has also implemented a number of anti-corruption measures, including requiring incoming ministers to declare their assets, drafting a code of conduct for the civil service, publishing an ECOWAS audit of the previous government, and preparing for judicial action against officials named in that audit.

11. We are pleased to report that good progress has been made in preparing an Interim Poverty Reduction Strategy Paper (I-PRSP). A draft I-PRSP has been completed and is being finalized in consultation with stakeholders and development partners. In line with our commitment expressed to you in April, we expect to be able to send the final I-PRSP document to the IMF and World Bank by end-September 2006.

12. The 2006/07 budget targets a cash balance, recognizing that any loan financing, whether external or domestic, will be imprudent for some time to come. The budget targets an increase in revenues of 43 percent over the 2005/06 fiscal year. While ambitious, we believe that this target is attainable, based on revenue performance during the last five months of the previous fiscal year and the significant further strengthening of revenue administration that we intend to implement. In order to broaden the revenue base, we also plan to eliminate some tax and tariff exemptions. Moreover, we expect to see benefits from a safer and more enabling security and business environment. We have also sought to enhance the poverty reduction impact of government expenditures. Thus, the budget for the social services subsector, which includes education and health care, has been increased by 56 percent, to a quarter of all government expenditure. Also, spending on community services and rural development, including agriculture and forestry, are slated to increase by 183 percent and 278 percent, respectively. We fully recognize that a strong domestic revenue mobilization effort is crucial to providing much needed additional resources to address Liberia's numerous poverty and development challenges. Moreover, we acknowledge the uncertainty about government revenues and the importance of implementing prioritized expenditure plans to ensure that appropriate adjustments to expenditures can be made, should the need arise.

13. In consultation with IMF staff, we have modified the end-September 2006 quantitative benchmarks of the SMP and developed preliminary quarterly benchmarks for the remainder of the 2006/07 fiscal year that are consistent with the 2006/07 budget (Table 1B).

Regarding the latter, it is our hope that these can be established as quantitative performance criteria under a rights accumulation program (RAP) that would succeed the SMP.

14. In June, the U.N. Security Council provisionally lifted sanctions on the export of timber from Liberia in recognition of our efforts to strengthen the management of forestry resources. Progress has also been made in making Liberia compliant with the Kimberley Process Certification Scheme, which should lead to the lifting of sanctions on diamond exports. We see the lifting of these sanctions and our performance under the SMP and the GEMAP as providing a foundation for the restoration of stability and growth, but recognize that deeper reforms are needed to sustain progress. Implementation of a solid macroeconomic framework under the SMP has already yielded substantial benefits in terms of improved fiscal performance and structural reforms, and ongoing Fund technical assistance provides important policy recommendations for both the short and medium-term. Liberia faces immense economic challenges and we remain committed to implementing the necessary reforms to continue on the path of economic recovery and poverty reduction.

15. We are working with our development partners on programs to address the government's crippling capacity constraints, including the concept of a Senior Executive Service to fill technical needs below the ministerial level. In the longer term, we expect that our efforts to reform the civil service will further enhance the capacity of the government to effectively implement its policies.

16. It is our view that, under the SMP, Liberia has demonstrated a credible strengthening of its cooperation with the IMF on economic policies. We also continue to meet our monthly payment commitments. Going forward, we remain strongly committed to further improving our cooperation with the IMF with a view to resolving our arrears to the IMF and obtaining comprehensive relief on our unsustainable external debt as soon as possible. Against this background, we request that the IMF consider initiating the process of de-escalation of the remedial measures that are being applied against Liberia. The initiation of this process would provide an important confirmation to the long-suffering Liberian people and the international community that Liberia has indeed begun to turn the corner.

Sincerely yours,

/s/  
Antoinette M. Sayeh  
Minister of Finance

/s/  
J. Mills Jones  
Governor of the CBL

Table 1A. Liberia: Quantitative Indicators (flow basis)

(Millions of US\$)

	Jan. 06	Feb.-Mar.06		Apr.-Jun.06		Jul.-Sep.06
	Act.	Prog.	Act.	Prog.	Act.	Orig. Prog.
<b>Fiscal</b>						
Floor on revenue collections	8.1	14.1	18.1	24.7	27.0	20.3
Floor on cash-based fiscal balance <sup>1/</sup>	5.2	0.0	9.7	0.0	4.7	0.0
Ceiling on new noncash tax/duty payment	n.a.	0.0	0.0	0.0	0.0	0.0
Ceiling on new domestic borrowing	0.0	0.0	0.0	0.0	0.0	0.0
Ceiling on new external borrowing	0.0	0.0	0.0	0.0	0.0	0.0
Ceiling on new domestic arrears/payables (excluding the arrears arising from the current debt outstanding)	n.a.	0.0	0.0	0.0	0.0	0.0
	0.0	0.0	0.0	0.0	0.0	0.0
<b>CBL</b>						
Ceiling on expenses	1.5	0.9	0.6	2.2	0.5	0.9
Ceiling on payments arrears	n.a.	0.0	0.0	0.0	0.0	0.0
Floor on CBL's cash-based budget balance	-1.3	-0.3	0.0	-1.2	0.8	0.1
Floor on the changes in CBL's net foreign exchange position	-0.8	0.2	3.5	1.8	4.4	3.1
<b>Other</b>						
Floor on token payments to the Fund (in US\$)	60,000	120,000	120,000	180,000	180,000	180,000

1/ The fiscal balance, on a cash basis, is defined as the difference between (a) total central government revenue plus budget support (excluding project grants), and (b) total current expenditure plus investment expenditure (excluding foreign-financed investment expenditure).

Table 1B. Liberia: Quantitative Indicators 2006/07 (cumulative basis, unless otherwise noted)

(Millions of U.S. dollars)

	Jun. 06 <sup>2/</sup>	Sep. 06		Dec. 06	Mar. 07	Jun. 07
	Act.	Orig. Prog.	Rev. Prog.	Prel. Proj.	Prel. Proj.	Prel. Proj.
<b>Fiscal</b>						
Floor on revenue collections	84.6	20.3	24.7	50.9	84.5	120.9
Floor on cash-based fiscal balance <sup>1/</sup>	19.5	0.0	-19.5	-19.5	-19.5	-19.5
Ceiling on new noncash tax/duty payment (continuous basis)	0.0	0.0	0.0	0.0	0.0	0.0
Ceiling on new domestic borrowing (continuous basis)	0.0	0.0	0.0	0.0	0.0	0.0
Ceiling on new external borrowing (continuous basis)	0.0	0.0	0.0	0.0	0.0	0.0
Ceiling on new domestic arrears/payables (excluding the arrears arising from the current debt outstanding) (continuous basis)	0.0	0.0	0.0	0.0	0.0	0.0
<b>CBL <sup>3/</sup></b>						
Ceiling on expenses	2.6	3.6	5.0	6.0	...	...
Ceiling on payments arrears (continuous basis)	0.0	0.0	0.0	0.0	...	...
Floor on CBL's cash-based budget balance	-0.4	-0.4	-1.8	-1.9	...	...
Floor on the CBL's net foreign exchange position	13.6	16.7	16.1	19.9	...	...
<b>Other</b>						
Floor on token payments to the Fund (in US\$) (continuous basis)	680,000	180,000	180,000	360,000	540,000	720,000

1/ The fiscal balance, on a cash basis, is defined as the difference between (a) total central government revenue plus budget support (excluding project grants), and (b) total current expenditure plus investment expenditure (excluding foreign-financed investment expenditure).

2/ The floor on revenue collections is total revenue for 2005/06 and the floor on cash-based fiscal balance is accumulated government surpluses at the CBL as of end-June. Most of the latter amount represents checks approved by the CMCo prior to end-2005/06 which were not cashed prior to end-2005/06. After taking into account commitments made, but not cashed, the balance of the government account at the CBL at end-June 2006 was \$2.1 million. Under the cash-based budget, these are recorded as expenditures when they are cashed at the CBL. All CBL data are Jan.-Jun. 2006.

3/ The original program data for September 2006 reflects actual outturn at end-June, plus the original flow targets for September.

Table 2. SMP for February-September 2006—Structural Benchmarks

Measures	Target dates	Status
<b>Fiscal Management</b>		
Strengthen the Large Taxpayer Unit (LTU) <ul style="list-style-type: none"> <li>• Create a large taxpayer audit unit inside the LTU with reallocation of staff within MoF</li> <li>• Introduce a monthly information exchange to the LTU from BIVAC</li> </ul>	End-March 2006	Done
Increase the number of large taxpayers from 60 to 110 by auditing hidden taxpayers and/or lowering the threshold value	End-June 2006	Ongoing – expected to be completed by end-September
Develop a timetable to ensure approval of the 2006/07 budget	End-March 2006	Done
Submit budget for legislative approval prior to commencement of fiscal year	End-June 2006	Done
Develop a strategy to deal with overdue tax obligations	End-June 2006	Done
Implement an interim commitment control system in accordance with FAD TA recommendations: <ul style="list-style-type: none"> <li>• The Bureau of the Budget to only allocate to line ministries in line with monthly cash plans</li> <li>• The line ministries to ensure that their commitments do not exceed allotments</li> <li>• The MoF to issue a public announcement that only purchase orders with the Bureau of General Accounting's special seal would be valid</li> </ul>	Continuous from end-June 2006	Ongoing – expected to become effective after approval of the 2006/07 budget
Integrate the Bureau of the Budget and the Bureau of Maritime Affairs into the Ministry of Finance	End-June 2006	Ongoing – legislation expected to be submitted after approval of the 2006/07 budget
Establish the stock of domestic debt of the GOL, and complete the verification process	End-June 2006	Ongoing – expected to be completed by end-September
Finalize the domestic debt resolution strategy, consistent with a restructuring plan for the CBL	End-September 2006	

Table 2. SMP for February-September 2006—Structural Benchmarks (cont.)

Measures	Target dates	Status
<b>CBL operations</b>		
Revise the terms of reference for the money management committee to reflect the new responsibility of monetary policy, and ensure the committee operates in accordance with its ToR	Continuous from end-March 2006	Done
Publicize the final Monetary Policy Framework paper on the CBL website	End-March 2006	Done
Formulate a financial restructuring plan for CBL in collaboration with GOL, supported by IMF TA experts	End-September 2006	
Hold regular weekly or biweekly foreign exchange auctions	Continuous from end-March 2006	Done
Conduct an external audit of the CBL by auditors of international reputation	End-September 2006	
<b>Governance and other issues</b>		
Finalize the program for prioritizing and reviewing all concessions, contracts, and licenses granted under NTGL, and identify associated revenue flows, with assistance provided by international partners	End-April 2006	Done, approved by EGSC in early May 2006
Complete review of concessions, contracts, and licenses granted under the NTGL, with assistance provided by international partners	End-September 2006	
Implement recommendations of audit of travel expenses, including revision of policy on travel allowances	Continuous from end-March 2006	Done, issued on April 1, 2006
Develop a national anti-corruption strategy for the GOL, including a policy matrix for implementation, with assistance provided by international partners	End-May 2006	Ongoing – expected to be completed by end-September
Post on MoF’s website complete financial statements of revenue-generating agencies (National Ports Authority, Roberts International Airport, Liberian Petroleum Refining Corporation, Forestry Development Authority, and Bureau of Maritime Affairs), endorsed by financial controllers	End-September 2006	
Submit a status report, endorsed by the Economic Governance Steering Committee, on implementation of the Governance and Economic Management Assistance Program	End-September 2006	